2002

Report of the
Auditor General of Canada
to the House of Commons

DECEMBER

Matters of Special Importance—2002
Foreword and Main Points

Office of the Auditor General of Canada

The December 2002 Report of the Auditor General of Canada comprises 11 chapters, Matters of Special Importance—2002, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

Ce document est également disponible en français.

© Minister of Public Works and Government Services Canada 2002
Cat. No. FA1-2002/2-0E
ISBN 0-662-33106-0

103-01313/

Auditor General of Canada
Verificatrice générale du Canada

To the Honourable Speaker of the House of Commons:

I have the honour to transmit herewith my annual Report of 2002 to the House of Commons, which is to be laid before the House in accordance with the provisions of subsection 7(3) of the *Auditor General Act*.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

OTTAWA, 3 December 2002

Foreword

Report of the Auditor General of Canada to the House of Commons—December 2002

Foreword

I am pleased to present my annual Report for 2002. It contains Matters of Special Importance—2002 and the following 11 chapters:

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada—Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada—Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

The Main Points of the chapters are reprinted at the end of this publication.

Matters of Special Importance—2002

Table of Contents

Main Points 1

Introduction 3

A tradition based on sound principles 3

Fulfilling the mandate of the Office of the Auditor General 3
Maintaining the Office's independence 6

Sound oversight by Parliament depends on sound information 7

The Canadian Firearms Program—What are the true costs? 7
Health care indicators—A step in the right direction but much more information needed on health care 8
Parliament needs better information on the performance of foundations and delegated arrangements 9

Government change initiatives—A gap between commitment and achievement 10

Strong leadership is an essential condition for change 10
Active monitoring is a must 11
There is a risk that the change initiatives will stall 12

Conclusion 13

Matters of Special Importance—2002

Main Points

1. This has been my first full year as Auditor General of Canada. It also marks the 25th anniversary of the amendments to the *Auditor General Act* that broadened the Auditor General's mandate to include value-for-money auditing.

2. Each year in this chapter, I highlight significant issues based on our work of the past year. This year I focus on two: Parliament's need for sound information, and government change initiatives.

3. **The need for sound information to Parliament.** In order to hold government accountable and to make enlightened decisions on matters of policy, Parliament needs reliable and sound information on program costs and performance. In this section I give as examples three areas where information is simply not adequate to meet the needs of Parliament—the Canadian Firearms Program, health care, and foundations and other delegated arrangements.

4. **Government change initiatives.** The government has undertaken many significant initiatives, all with a view to improving its management—from the introduction of modern comptrollership to the reform of human resources management to providing Canadians with access to government on-line. These initiatives have commendable goals and ambitious agendas but have progressed too slowly and, as a consequence, risk becoming stalled. I stress that strong leadership and active monitoring are essential to the successful implementation of initiatives designed to improve government's management.

5. I begin this chapter by discussing the mandate and the independence of my Office, and our aim to help the government improve the management of its programs and its accountability to Parliament. In particular, I set out the five areas where I want my Office to produce positive results during my term as Auditor General.

Sheila Fraser, FCA
Auditor General of Canada

Introduction

6. This has been my first full year as Auditor General of Canada. It also marks the 25th anniversary of the amendments to the *Auditor General Act* that added value-for-money auditing to our duties. Since 1977, the Auditor General has had a broader mandate to report on whether government policies are implemented economically, efficiently, and with adequate means for judging their effectiveness—that is, whether Canadians have received value for their tax dollars. This is a big responsibility, and I am proud of the professional way my Office fulfils this mandate.

7. In 2003, the Office will celebrate the 125th anniversary of the appointment of the first independent Auditor General of Canada. Originally, the Auditor General's mandate was to examine each expenditure and certify that the government had kept correct accounts. Annual reports to the House of Commons covered the government's activities down to the smallest detail. Today, given the size of the government, it is impossible to look at every transaction. However, one fact remains as true today as it was 125 years ago: Parliament has the right to require that the government keep it fully informed and to count on the Auditor General for assurance that the information it gets is reliable.

8. Against this backdrop are the matters set out in this chapter:

- A tradition based on sound principles—Fulfilling the mandate and maintaining the independence of the Office
- Sound oversight by Parliament depends on sound information
- Government change initiatives—A gap between commitment and achievement

A tradition based on sound principles

Fulfilling the mandate of the Office of the Auditor General

9. On several occasions since my appointment as Auditor General, I have noted that the role of the Office is not always clearly understood. I would like to take this occasion to describe briefly what we do.

10. Though it is often said that my role is to be "a watchdog," in the end it is Parliament whose role is to keep a watch on the government. As Auditor General, my job is to alert Parliament to significant issues our audits identify in the way government is being managed, by providing parliamentarians with timely, relevant, audit-based information.

11. My Office does not consider the merits of the government's policies. Rather, we observe how its policies are carried out and, where appropriate, we recommend ways to improve those activities. Ultimately, all our work is aimed at helping the government improve the way it manages its programs and accounts to Parliament and the public for the results. Our work is varied but always focussed on a single goal: to serve Parliament, and thereby to serve Canadians.

What We Do

The *Auditor General Act* assigns us three main lines of work:

- **Compliance audit.** The government cannot collect money from the public and spend it without Parliament's approval. Our audits draw to Parliament's attention instances where the government has not complied, in all significant matters, with laws and regulations.
- **Attest audit.** Each year, I formulate an opinion on the government's financial statements. My opinion indicates whether the financial statements portray fairly the government's financial position and the results of its operations.
- **Value-for-money audit.** We verify whether programs delivered by federal departments and agencies have been carried out economically and efficiently with due regard to their effects on the environment. We also note whether the government has adequate methods to measure the effectiveness of programs. In short, we try to answer the question: Are taxpayers getting value for their money?

My Office asks similar questions about the Crown corporations and other organizations I am appointed to audit.

12 [illegible]

13 [illegible]

14 [illegible]

- [illegible]
- [illegible]
- [illegible]
- [illegible]
- [illegible]

[illegible]

My Priorities

- **Accountability to Parliament.** Here we will assist and support Parliament in its work of authorizing and overseeing government spending and operations. We will examine new governance arrangements and continue our work in the areas of financial and non-financial performance reporting, accountability, and compliance with authorities. We will work more closely with parliamentary committees providing information and assurance to assist them in their duties.
- **An effective public service.** In this area, we will assess the government's capacity to develop policies, deliver programs, and provide administrative support for program delivery. Our work will address areas such as [illegible] management, financial management, information technology, and [illegible] management. We will follow and report on government's progress in these and other areas, with a focus on progress made and results achieved.
- **The health, safety, security, and environment of Canadians** [illegible] Here our work will focus on [illegible] how the government [illegible] today. We will examine [illegible] programs [illegible] and assess how well these programs [illegible]
- **The legacy and heritage we will leave our children.** In this area we will [illegible] Canada's natural, historical [illegible] financial health. As a first step, we will identify the [illegible] situation we have inherited from previous generations. We will then assess the programs designed to maintain and develop those assets for future generations.
- **Aboriginal issues.** Here we will look at some of the [illegible] facing Canada today. We will concentrate our work on the government programs that [illegible] the social, economic, and environmental conditions faced by Aboriginal peoples and their communities. With a view to improving the efficiency and effectiveness of program delivery, we will pay special attention to [illegible] partnerships, and [illegible]

16 [illegible] public [illegible] democratic institutions

[illegible]

17 [illegible]

What We Do

The *Auditor General Act* assigns us three main lines of work:

- **Compliance audit.** The government cannot collect money from the public and spend it without Parliament's approval. Our audits draw to Parliament's attention instances where the government has not complied, in all significant matters, with laws and regulations.
- **Attest audit.** Each year, I formulate an opinion on the government's financial statements. My opinion indicates whether the financial statements portray fairly the government's financial position and the results of its operations.
- **Value-for-money audit.** We verify whether programs delivered by federal departments and agencies have been carried out economically and efficiently with due regard to their effects on the environment. We also note whether the government has adequate methods to measure the effectiveness of programs. In short, we try to answer the question, Are taxpayers getting value for their money?

My Office asks similar questions about the Crown corporations and other organizations I am appointed to audit.

---

12. Often I am asked how we choose what to look at in a value-for-money audit. With only enough resources to conduct 25 to 30 value-for-money audits each year, we have difficult choices to make. We use a process—one-pass planning—that provides a risk-based approach to our long-term audit planning. We look at the major risks faced by an organization, and we decide which of the types of audit work we do will best address those risks. We also take into account the level of interest that parliamentarians and the public have displayed in a program or subject. And what we choose to audit must fall within our mandate. For example, we do not have a mandate to audit certain entities created by the government, such as the Canada Millennium Scholarship Fund, or certain Crown corporations—Canada Post, for instance.

13. Our choice of what to audit also reflects my priorities. Like my predecessors, when I was named Auditor General I asked myself what areas I wanted my Office to help change for the better during my term. I have identified five areas as my priorities—two that traditionally have interested auditors general and three that focus on people and are important to all Canadians, including me and my family.

14. These five areas are

- accountability to Parliament;
- an effective public service;
- the well-being of Canadians—their health, safety, security, and environment;
- the legacy and heritage we will leave our children; and
- Aboriginal issues.

We have done audits in all of these areas but are now working hard at a more targeted, integrated, and cohesive approach to each of them.

My Priorities

- **Accountability to Parliament.** Here we will assist and support Parliament in its work of authorizing and overseeing government spending and operations. We will examine new governance arrangements and continue our work in the areas of financial and non-financial performance reporting, accountability, and compliance with authorities. We will work more closely with parliamentary committees, providing information and assurance to assist them in their duties.
- **An effective public service.** In this area, we will assess the government's capacity to develop policies, deliver programs, and provide administrative support for program delivery. Our work will address areas such as human resources management, financial management, information technology, and knowledge management. We will follow and report on government initiatives in these and other areas, with a focus on progress made and results achieved.
- **The health, safety, security, and environment of Canadians**—their well-being. Here our work will focus on citizens and how the government is meeting their needs today. We will examine individual programs in each of these areas and will also assess how well these programs are co-ordinated and managed across government.
- **The legacy and heritage we will leave our children.** In this area we will direct our work to Canada's cultural, historical, and physical assets, its environment, and its financial health. As a first step, we must identify the assets and describe the situation we have inherited from previous generations. We will then assess the programs designed to maintain and develop these assets for future generations.
- **Aboriginal issues.** Here we will look at some of the major challenges facing Canada today. We will concentrate our work on the government programs that influence the social, economic, and environmental conditions faced by Aboriginal peoples and their communities. With a view to improving the efficiency and effectiveness of program delivery, we will pay special attention to accountability structures, partnerships, and mechanisms for resolving disputes.

15 **Contributing to public confidence in our democratic institutions.** We must never forget that in large part, the confidence that Canadians have in our democratic institutions is based on the belief that public funds are being spent prudently and cost-effectively.

16. After tabling one of our reports, I am sometimes asked if Canadians should still have confidence in our government institutions, given the waste and inefficiencies we report. But auditing does not stop at revealing flaws. Our value-for-money audits also aim to identify ways to help the government improve its economy, efficiency, effectiveness, and environmental performance. That we find room for improvement does not always mean the government is doing its work poorly, simply that it can do better.

17. Where a program is doing poorly, the challenge for auditors is to go beyond reporting poor performance and identify concrete steps to improve it—to bring about positive changes in government management. When departments respond to our reports by carrying out our recommendations, when parliamentary committees study our reports and make their own recommendations for action, government management does change for the better.

18. In fact, most of what I have seen leads me to believe that public servants and members of Parliament have at heart the good management of public money to meet the needs of Canadians. So when I give interviews, or make speeches, I try to talk about the importance of Parliament and the dedication of parliamentarians, the very demanding work they accomplish, often at great personal sacrifice. And I say the same of public servants.

19. One of the most satisfying aspects of my work is when I can point to good practices and real progress in government programs. Not only are these improvements important on their own, but they provide constructive models for others to emulate.

20. It is also important to realize that publishing audit reports contributes to the transparency of government activities. Recently a Member of Parliament said, "If there were not a diet of negativity coming out of the Auditor General's office, public confidence would be tremendously eroded. One of the qualities of having an open democracy is the fact that this type of negativity does occur." Seen in that way, hearing about what is not working well is healthy and positive.

21. There is no doubt that the federal government is more transparent and accountable than a private company and so, too, must be the auditing of government. For example, I may outline in my observations on the government's financial statements detailed results of my audit and ways the government can improve its financial reporting. In addition, all my audit reports may become the subject of debate in the House of Commons, the Senate, or parliamentary committees.

22. Should Canadians still have confidence in government institutions, despite the waste and inefficiencies the Auditor General reports? Yes, I believe our institutions are sound, despite these flaws. And in my opinion, the existence of an independent audit office, reporting to Parliament, that assesses the government's performance objectively, suggests improvements, and measures the government's progress in implementing them should contribute to public confidence in our institutions.

Maintaining the Office's independence

23. To do our work properly, we have to be credible; and to be credible, we have to be independent. Recent financial scandals in private sector companies have raised a number of questions about the auditor's role and independence. As the auditor of the federal government, I believe that the mechanisms in place to ensure the independence of my Office are, on the whole, quite solid:

- The Auditor General is appointed for a 10-year term that is not renewable. I present my conclusions directly to Parliament when I am ready to do so.
- I am accountable to Parliament, not to the government of the day. That means the government cannot fire me if my reports embarrass it.

- I can ask the government for any information I need to carry out my mandate.
- We do not depend on receiving fees for our services from departments and agencies that we audit. Rather, we are funded by Parliament.

24. At the same time, I believe—like my predecessor, Denis Desautels—that we must actively protect the Office's independence. At present, like almost all federal departments and agencies, my Office negotiates its budget with representatives of the Treasury Board Secretariat. So far, this has not caused a problem; but as a matter of principle, this situation should be corrected so there is no possibility of undue influence, real or perceived.

25. Last year the Secretariat and my Office agreed to discuss a more formal process for determining future years' funding of the Office's requirements. In my view, such a process should establish a balance between the independence of the Auditor General and the rightful challenge to our expenditure of public funds. Discussion is continuing.

Sound oversight by Parliament depends on sound information

26. There is rarely unanimous support for government intervention in a particular policy area, or for the form that intervention should take. Moreover, most of the issues that the government attempts to deal with are complex. Solutions often require that more than one department—and more than one level of government—focus on a problem at the same time.

27. A large part of parliamentarians' work surrounds matters of public policy. Members may debate the creation of a program or the introduction of legislation to meet a need identified by the government. They may also look at, for example, whether a program has adequate funding or whether legislation needs to be amended.

28. Good decisions require good information. Reaching a consensus in parliamentary debate does not depend solely on full information about the challenges and stakes involved. Nor will every aspect of a situation be known before action must be taken.

29. Parliamentarians and public servants alike may be called on to make decisions involving huge sums of public money without having the information they need. And parliamentarians also need sound information to hold the government accountable for federal public policy. But the information is not always provided.

The Canadian Firearms Program—What are the true costs?

30. In Chapter 10 of this report, I comment on the lack of information to Parliament about the mounting costs of the Canadian Firearms Program. I am concerned that the projected costs of implementing the program have risen from an initial estimate of $119 million ($2.2 million net of expected revenues) to over $1 billion by 2004–05, with little notice given to Parliament. Not only did Parliament receive insufficient information on the increase in the appropriate Estimates documents, but the additional spending was approved largely through supplementary estimates rather than, as usual, through the main estimates. Parliament could not effectively scrutinize the program's costs because it lacked the information.

Health care indicators—A step in the right direction but much more information needed on health care

31. Health care is another area suffering from weak information. As I noted in October in our Status Report, Chapter 3, the federal government contributes to the health care spending of the provinces and territories through the Canada Health and Social Transfer. This is a block transfer to the provinces and territories that they may allocate to health care, post-secondary education, and social assistance, according to their own priorities.

32. While the total amount of the block transfer is known, however, the health portion is not. The provinces and territories do not tell the federal government how much of the federal funding is directed to health care. Nor does the federal government indicate what it intends to contribute. As a result, no one can say how much the federal government is contributing to health care. This limits the debate on the future of our health care system.

33. The *Canada Health Act* requires the provinces and territories to satisfy certain conditions in order to receive the Canada Health and Social Transfer from the federal government. It stipulates that Health Canada must monitor how well the provinces and territories satisfy the Act's criteria and conditions for payment and that it must report this to Parliament every year.

34. I noted in the chapter that the Department is still not telling Parliament to what extent each province and territory complies with the Act, partly because it lacks the information itself. Rather, Health Canada's annual reports on the *Canada Health Act* focus more on a general description of each province's and territory's health insurance plan.

35. It has now been more than 15 years since my Office first pointed out the weaknesses in the information these reports on the Act present to Parliament. The reports do not help parliamentarians determine whether the billions of dollars transferred to the provinces for health care have been spent in compliance with the criteria and conditions for payment set out by Parliament in the *Canada Health Act*.

36. I observed earlier that one of the most satisfying aspects of my work is being able to point to good practices. As we note in Chapter 6 of this Report, on health statistics, Canada's First Ministers mandated their ministers of health to report regularly on the performance of health programs and services, using common indicators. This fall, for the first time, the federal, provincial, and territorial governments published their health indicator reports.

37. In addition, First Ministers agreed to have the health information contained in the reports validated by a third party. Each of Canada's legislative auditors was appointed by its government — in my case, the federal government — to verify the accuracy of the data. Because I am also the legislative auditor of the three territories, my Office verified their health indicator reports. In my view, adding an opinion to the health information attesting to its validity makes the reports more credible.

38. This is an innovative and creative way of providing information to Canadians. The First Ministers were aware that publishing such indicators would lead to comparisons between jurisdictions. They were also aware of the importance of accounting to Canadians for the way health programs and services are managed, and they acted accordingly.

39. These reports, validated by legislative auditors, are a promising source of information that will assist parliamentarians and Canadians in judging the effectiveness of our health care system.

Parliament needs better information on the performance of foundations and delegated arrangements

40. The federal government has handed over billions of taxpayers' dollars to various foundations and other delegated arrangements set up to achieve public policy objectives. In our April Report, Chapter 1, Placing the Public's Money Beyond Parliament's Reach, I was critical of the information provided to Parliament on these arrangements.

41. Our audit found that while Parliament has received some useful information about most new arrangements, the information on their performance still leaves considerable room for improvement. For example, some did not provide an annual report with a credible description of accomplishments. In addition, the chapter noted that Parliament is not receiving reports on independent, broad-scope audits that go beyond the financial statements of these arrangements to examine their compliance with authorities and the value they provide for the taxpayers' money they spend. We also emphasized that the Auditor General should be appointed as the external auditor of foundations, with a few exceptions.

42. Adequate external audit and credible reporting of results are essential conditions for accountability to Parliament. I believe those conditions are not being met, a gap that undermines good governance and accountability to Parliament. The lack of sound information provided to Parliament limits its ability to scrutinize how substantial amounts of public money are being used. I am also concerned that effective ministerial oversight is hampered by the limited means available to ministers to intervene in cases where the public purpose of the arrangement is not met or where circumstances have changed considerably since the creation of the arrangement.

Government change initiatives—A gap between commitment and achievement

43. The federal government has taken steps to strengthen management from the modernization of comptrollership to reform of human resources management to government on-line. These initiatives are guided by the vision outlined in *Results for Canadians: A Management Framework for the Government of Canada*, issued by the President of the Treasury Board in March 2000.

44. In that document, the government made four commitments:

- It would sharpen its focus on citizens.
- Public service managers would be guided by a clear set of values.
- Management would focus on achieving results and reporting them in simple and understandable ways.
- The government would ensure that spending was responsible.

45. These goals are commendable, and the government has set an ambitious agenda for achieving them. Given the size of government, any initiative that seeks to change the way government functions, no matter how desirable, is a formidable challenge.

46. To succeed, these long-term initiatives require a strong commitment to change on the part of senior management and the central agencies—and that commitment must be translated into concrete action. It is vital to provide direction that is clear. It is not enough to say where we must go; we also have to explain how we will get there. Those responsible for implementation must be held accountable for achieving key milestones by specific dates. Anything less leaves important initiatives vulnerable.

Strong leadership is an essential condition for change

47. As government's management board, the Treasury Board and its Secretariat have clearly been designated to lead these change initiatives. As noted in *Results for Canadians*, the management board must "act as a catalyst for change and work with departments and agencies to develop integrated, accessible, citizen-focussed service across the Government of Canada."

48. Strong leadership is sometimes lacking. Our April chapter, Strategies to Implement Modern Comptrollership, noted that the Treasury Board Secretariat has not stated the results it wants clearly enough to be able to hold departments and agencies accountable for achieving them. Nor are there clear target dates for these results. I believe the Treasury Board Secretariat must provide firmer leadership by establishing clearer expected results and implementation plans.

49. Another example of a lack of leadership is in the area of financial management and control. As Chapter 5 of this Report observes, financial management reform and the pursuit of effective financial management have been on the agenda of the Government of Canada for over 40 years. In spite of recent progress, much remains to be done. Among other things, line managers still lack proper information on the assets, liabilities, and costs of programs they manage. The government still has not fully implemented accrual accounting, and it is still studying what do to about accrual-based budgeting.

50. This is not acceptable for an organization that spends almost $180 billion a year. It is time for the government to get serious and to get on with the job. It needs to provide strong leadership, stop the never-ending studies, take decisions, develop implementation plans with aggressive target dates, and actively monitor the successful implementation of those plans. If the government as a whole is not committed, little will be done. And if the commitment is not led from the top, it will never extend to the far reaches of the entire bureaucracy.

51. I was therefore encouraged to see that the Clerk of the Privy Council has made modern comptrollership one of the four priorities for deputy ministers and has incorporated it into their performance agreements. It is vital that senior management demonstrate support and firm commitment to ensure the success of this modern comptrollership initiative.

52. But more is needed. It is often said that management reforms must be accompanied by a change in an organization's culture. Managers will not change their practices and behaviours unless they understand how doing so will serve their interests. Yet, as we observed in our April chapter, Strategies to Implement Modern Comptrollership, many public servants do not fully understand this initiative. More education is needed and more consideration needs to be given to the incentives to change: Are there true encouragements to change? Are incentives clear and meaningful? Are there clear consequences for failing to achieve targets?

Active monitoring is a must

53. Direction must be provided, and progress monitored. The Treasury Board Secretariat's responsibility for active monitoring is set out in various policies. The Secretariat needs to ensure that departments and agencies keep on track and on schedule for implementing government-wide initiatives and policies. It has to monitor, co-ordinate, and facilitate the measures taken by the departments, and to do this it must have the necessary information at hand.

54. Our audits have shown that the Secretariat will need to strengthen its efforts if it wants to monitor progress meaningfully. Not only must it ask departments to provide action plans—with clear objectives and precise timelines—and to report on progress, but it must also carefully examine the relevance of those plans and assess departments' ability to deliver what they promise. Otherwise, the Secretariat cannot have an overall appreciation of what remains to be achieved. Nor can it take action quickly when problems arise or initiatives stall. In certain cases, a serious change of course may be needed; in other cases, it may be more targeted action that is required.

There is a risk that the change initiatives will stall

55. If the two conditions I have mentioned—strong leadership and active monitoring—are not met, there is a risk that the initiatives will founder. Some examples noted in recent audits illustrate this.

56. **Information technology security.** In my April Report, Chapter 3 on this issue noted that the government recognized the need to protect its information systems and networks. This is even more important given the government's initiative to provide Canadians with on-line access to its services.

57. When the revised version of the Government Security Policy came into effect early in the year, it was certainly a step in the right direction. However, as the audit found, the Treasury Board Secretariat had not updated the standards that support the Policy. Without updated standards, the revised policy has little effect and the information technology security initiative could stall.

58. **Human resources management reform.** Last year, the government set itself an ambitious timetable for modernizing human resources management in the public service. The Task Force on Modernizing Human Resources Management, set up to study that subject, was supposed to recommend a modern framework for human resources management before summer 2002. The government also undertook a study of possible changes to human resources policies, procedures, and systems that would not require legislative measures.

59 The government has put initiatives in place, and my Office will follow up on them next spring. At this writing, no legislative amendments have been introduced. This concerns me because much is at stake, and a significant delay could lead to increased cynicism among public servants.

60. I believe that public servants have high expectations for this initiative. I will continue to monitor closely the government's efforts to improve the way the public service attracts, retains, and trains the talented people it needs to serve Canadians well.

61. **Adoption of full accrual accounting.** In 1995, the government announced that it would replace its current method of modified cash accounting with full accrual accounting. Accrual accounting recognizes transactions and other events when they occur, rather than when cash or its equivalent is received or paid. Accrual financial information helps users appreciate the full scope of government—the resources, obligations, financing, and impacts of its activities.

62. Much effort has been invested in this initiative. Departments and agencies took a major step forward in April 2001 by implementing new financial systems that will allow them to provide information based on accrual accounting. In 2001–02, the government was to produce its first financial statements using full accrual accounting.

63. However, as I noted in my observations on the government's financial statements for 2001–02, the introduction of accrual accounting has been delayed by at least a year. I strongly support this important initiative and while there are still some challenges to be met, I do not believe they are insurmountable if they receive sustained attention. I encourage the government to move forward on this.

64. **Sustainable development strategies.** In 1997, the first sustainable development strategies of major departments and agencies were tabled in the House of Commons. The strategies are updated every three years. While not part of current management change initiatives, they are instructive about the dangers of theory outstripping practice.

65. In her 2002 Report, the Commissioner of the Environment and Sustainable Development recalls that following the government's commitment in 1995 to take action toward sustainable development, federal departments and agencies were to prepare sustainable development strategies. In these documents, they were to include action plans for integrating sustainable development into their policies, programs, and activities. The Commissioner concludes in her Report that the sustainable development strategies she reviewed have not achieved their purpose.

66. In order to make sustainable development a reality, the strategies should provide a vision of a sustainable future as well as specific long-term goals. To achieve this, all federal ministers must provide the leadership and commitment necessary to turn words into actions.

Conclusion

67. The various change initiatives under way in the government are important, with their common goal of improving service to Canadians through better-managed programs. These initiatives are a response to real needs—ensuring that information technology systems are secure against new, more sophisticated threats; recruiting and retaining a talented workforce; ensuring that departments and agencies have the financial and non-financial information needed for sound program decisions. These are needs that have been clearly articulated for some time.

68. Our audits this year and in the past reveal that the government must go beyond stating principles and put into effect clear, detailed plans of action. It cannot do this without providing strong leadership and active monitoring. While I will continue for my part to examine the progress of specific government initiatives and inform Parliament, I encourage the government to provide more information itself to Parliament about these change initiatives, the progress achieved, and any difficulties encountered.

69. I would like to conclude on a more personal note by thanking my colleagues for their effort and their ability to deal with the many challenges we have faced together during this past year. I feel privileged to be able to work with some 600 people who are so competent and so dedicated to serving Parliament and Canadians. I know that we can continue to make a difference for Canadians, which has been our goal and our motivation for almost 125 years.

Main Points

Table of Contents

Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations 1

Chapter 2 Fisheries and Oceans Canada—Contributing to Safe and Efficient Marine Navigation 3

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports 5

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents 7

Chapter 5 Financial Management and Control in the Government of Canada 9

Chapter 6 Statistics Canada—Managing the Quality of Health Statistics 11

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program 14

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space 16

Chapter 9 Modernizing Accountability in the Public Sector 18

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program 20

Chapter 11 Other Audit Observations 22

Streamlining First Nations Reporting to Federal Organizations

Chapter 1

Main Points

1.1 First Nations reporting requirements established by federal government organizations are a significant burden, especially for communities with fewer than 500 residents. We estimated that at least 168 reports are required annually by the four federal organizations that provided the most funding for major federal programs.

1.2 We found overlap and duplication among the required reports. With the exception of some financial reports, limited use is being made of the reports by the federal organizations sampled, and we suggest that fundamental change is required. We found the following:

- Reporting requirements are dictated, not based on consultation.
- The information reported is generally not used to set funding levels.
- The reports contain information that does not reflect community priorities.
- We noted that new reports are being introduced with little or no review of the reporting requirements for existing programs, adding to the reporting burden.
- There is little feedback to the First Nations, except for an analysis of audited financial statements.
- Most required reports for Indian and Northern Affairs Canada (INAC) and Health Canada do not provide adequate information on performance or results.
- Little of the information being collected from the First Nations is being used by a number of the federal organizations in their reports to Parliament.

1.3 We are concerned about the burden associated with the federal reporting requirements. Resources used to meet these reporting requirements could be better used to provide direct support to the community. Steps need to be taken to streamline reporting requirements. The current program structure established by the federal organizations is an obstacle to reforming reporting requirements and needs to be reviewed.

Background and other observations

1.4 The reporting relationship between the First Nations and the federal organizations has evolved significantly over the last few decades. Today, communities deliver programs and services and administer annual budgets that can be in the millions of dollars. This has increased the reporting requirements within the communities and from the communities to federal organizations.

1.5 The study reported here focussed on the reporting requirements of funding agreements between the federal government and First Nations. Although the Auditor General is not the auditor of First Nations, we wanted to reflect their perspectives. The Federation of Saskatchewan Indian Nations assisted us and as a result, four First Nations and two tribal councils in Saskatchewan volunteered to participate in the study.

1.6 Our study was not intended to provide a complete view of national reporting. However, as the same reports are required in every region of the country, the study does shed light on issues that are relevant across Canada. It also suggests criteria for reporting.

The federal government has responded. The government's response is included at the end of the chapter. The government agrees with the recommendations in the study, and accepts the desire to reduce the reporting burden on First Nations.

Fisheries and Oceans Canada
Contributing to Safe and Efficient Marine Navigation

Chapter 2

Main Points

2.1 Fisheries and Oceans Canada is one of several departments and agencies that contribute toward the safe and efficient navigation of vessels in Canada's waterways. We focussed on the Department's role in preventing accidents and supporting the efficient navigation of our waterways.

2.2 We found that users of Canada's navigational support services generally consider them to support safe waterways and provide services that generally meet their navigational requirements. However, the Department has limited performance information that shows how it contributes to safe and efficient marine navigation. The Department has not cost-effectively managed the functions we examined and changes must be made to ensure the services continue to meet user needs in the future.

2.3 The Department faces changing service demands, evolving waterway usage, continuing fiscal pressure, and increasing technological demands because of international obligations and advances in the shipping industry.

2.4 There are significant barriers preventing the Department from modernizing and delivering its navigational support services and boating safety activities cost-effectively, including

- failure to ensure that there is one national program,
- regional operations that are not held accountable for implementing national policies and meeting international obligations,
- key elements not present to ensure accountability,
- inadequate integration of navigational support services,
- provision of a service that does not contribute to the mandate for safety and efficiency, and
- outdated legislation used for unintended purposes.

2.5 While new technologies and services have been introduced since 1983, many of our current observations about the Canadian Coast Guard are similar to observations in our 1983 Report, Chapter 13, Marine Transportation Program, and in our 2000 Report, Chapter 31, Fleet Management. We are concerned that the Department has not yet dealt with these management issues.

Background and other observations

2.6 The Department carries out both preventive and responsive activities to support its commitment to maritime safety and efficient use of Canada's waterways. In this audit, we examined the preventive aspects of the

Department's commitment to safe and efficient waterways. We examined two important parts of these responsibilities: navigational support services and recreational boating safety.

2.7 The navigational support services that we examined included aids to navigation, channel maintenance, waterways protection, marine communications and traffic services, and navigational charts. The recreational boating safety activities that we examined included the programs that support the promotion of boating safety and the regulation of the construction, inspection, equipment, and operation of pleasure craft.

2.8 The activities that we examined had total estimated expenditures of $220 million (unaudited) in 2001–02. In addition, there were approximately $30 million (unaudited) in revenues, mostly associated with the Marine Services Fees.

2.9 The implementation of the Marine Services Fees has created a difficult working relationship with the marine industry. There still appears to be an underlying belief by industry that the Canadian Coast Guard has not been able to change sufficiently to deal with its concerns and that the fee is too high for the services that are provided. However, the Marine Services Fees have had a positive effect through the increased role of the marine industry in determining service levels.

The Department has responded. Fisheries and Oceans Canada accepts our findings. The Department's response to our recommendations, included in this chapter, describes the actions it is taking or intends to take.

Special Import Measures Act: Protecting Against Dumped or Subsidized Imports

Chapter 3

Main Points

3.1 In 1996 two parliamentary subcommittees conducted a significant review of the *Special Import Measures Act* (SIMA) and issued 16 recommendations to make it more efficient and responsive to Canada's economic needs. Our audit found that the government accepted all the recommendations except for part of two, and changes were made to the applicable legislation and regulations effective 15 April 2000.

3.2 We found that the Canada Customs and Revenue Agency (CCRA) and the Canadian International Trade Tribunal (CITT) have put in place the support and management processes needed to implement most of the recommendations. However, more work is needed to fully implement three key recommendations and address significant concerns in the following areas:

- access to confidential information,
- splitting responsibilities between the CCRA and the CITT, and
- access to the complaints process for small and medium-sized Canadian producers.

3.3 Issues related to granting counsel access to confidential information about the users' business was the greatest concern. Users, such as complainants, are generally satisfied that confidential information provided to domestic counsel will remain protected. However, they are greatly concerned about giving the confidential information to foreign counsel and expert witnesses. Furthermore, they are not convinced that the penalties in place for breach of confidentiality could be enforced. Participants in the SIMA process need to be assured of confidentiality in order for the system to have integrity. We also noted inconsistent requirements for access to confidential information by the Agency and the Tribunal. The CCRA is being challenged in the courts on its interpretation of who is entitled to have access to confidential information in particular circumstances.

3.4 In recent years there has been an increasingly heavy financial, time, and information burden associated with participating in the SIMA process. As a result, the process has become more difficult for users and the barriers to access may now be greater than they were before. Innovative ways need to be found to reduce these barriers wherever possible.

3.5 The subcommittees recommended that the CCRA take concrete measures to ensure fair and equal access to the SIMA process for small and medium-sized Canadian producers. The Agency produced a plan in response to the recommendation, but implementation has stalled since 1998.

Background and other observations

3.6 The SIMA provides a trade remedy system that protects Canadian producers from injury caused by dumped or subsidized goods imported into Canada. Trade remedy actions have had a relatively minor impact on the Canadian economy; by value, they affect about 1 percent of goods imported into Canada. In industries where they do apply, however, they have a substantial impact on Canadian producers and industries that use the imported goods. These include the steel and farming sectors, where dumped and subsidized goods have been found to cause serious financial difficulties. In one case, Canadian producers saw their gross margin of a specific steel product decline from 23 percent to 7 percent in six months. Their net income before taxes dropped $92 million, from $61 million to a loss of $31 million.

3.7 In 1996, the SIMA was reviewed by two House of Commons subcommittees: the Subcommittee on the Review of the *Special Import Measures Act* of the Standing Committee on Finance, and the Subcommittee on Trade Disputes of the Standing Committee on Foreign Affairs and International Trade. After many hearings, the subcommittees concluded that the SIMA was working well overall, and that it continued to be relevant to the competitive needs of the Canadian business community. At the same time, the subcommittees made 16 recommendations intended to make the Act more efficient and responsive to Canada's economic needs. Changes resulting from these recommendations have direct implications for SIMA stakeholders and users, including complainants, importers, exporters, trade experts, lawyers, and trade associations.

3.8 The subcommittees recommended that some administrative responsibilities be split between the CCRA and the CITT. We found that CCRA officers need additional training and guidance to meet their new responsibilities and that the Agency and the Tribunal need to work together to resolve inefficiencies that still exist.

The Agency and the Tribunal have responded. The Canada Customs and Revenue Agency and the Canadian International Trade Tribunal have generally agreed with our recommendations. Their responses, including the action that they are taking or intend to take to address the recommendations, are set out in the chapter. Action includes updating the guidelines on protection of confidential information, exploring options to provide more assistance to small and medium-sized Canadian producers, and consulting with each other to reduce administrative inefficiencies.

Canada Customs and Revenue Agency

Taxing International Transactions of Canadian Residents

Chapter 4

Main Points

4.1 The Canada Customs and Revenue Agency verifies that Canadian residents have complied with the tax rules on international transactions through audits carried out by specialized international auditors across the country. Our audit found that better risk assessment is needed to determine what compliance work should be undertaken in each tax services office and on a national basis. This is needed in order to provide an adequate check on the assessment of tax revenue from international transactions.

4.2 Expert staff is essential for an effective international audit program. The Agency must find ways to improve the program's human resource capability at a faster rate and explore ways to ensure that complex international audits are completed in a timely manner. In the Toronto area where 40 percent of large corporations file their tax returns, economic conditions have made recruiting and retaining international auditors difficult. The current staffing and level of training activities may not address this problem. In some tax services offices over one-third of the international audit staff have less than one year's experience and still require some training. Other staff, including some auditors of large corporations and auditors of small and medium businesses who were recruited without previous international tax experience still require basic international tax training.

4.3 The Agency needs to be more effective in carrying out audits of international issues. Strengthening its ability to provide advice on international business practice and providing economic analysis earlier in the audit process would reduce the time over which international audits are completed. The international audit program needs better information on the resources used to complete the audit of international issues, the tax reassessed, and the issues identified in reassessments in order to determine its future resource requirements and program directions.

Background and other observations

4.4 Canadian residents pay tax in Canada on their worldwide income. This includes the profits derived from sales of goods and services to non-residents, and dividends, capital gains, and interest resulting from their investments in foreign corporations or other foreign entities such as trusts.

4.5 There are specific rules that deal with the taxation of foreign transactions of Canadian residents. For example, transfers of goods and services between related parties must take place at arm's length prices. The foreign affiliate rules and the foreign accrual property income rules of the

Canadian *Income Tax Act* deal with dividends and other income from investments in foreign entities. Data reported by taxpayers to the Agency indicates that Canadian investments in foreign-related corporations and the value of cross border trade between companies within the same corporate group has increased significantly in recent years.

4.6 The International Tax Directorate of the Canada Customs and Revenue Agency administers the tax rules on international transactions with the assistance of several other divisions within the Agency. To ensure that taxpayers comply with the complex tax rules related to international transactions, the Agency uses information obtained from various sources, including information provided by taxpayers in tax returns and in other information returns. Based on this information, auditors select files and conduct audits on the international transactions made by taxpayers.

The Agency has responded. The Canada Customs and Revenue Agency agrees with our recommendations and in its responses, has indicated the actions it will take to address them.

Financial Management and Control in the Government of Canada

Chapter 5

Main Points

5.1 Financial management reform has been an elusive goal in the Government of Canada for over 40 years. There has been recent progress in this area, including the implementation of accrual accounting policies in departments and the development of guidance to implement modern comptrollership. Nevertheless, more progress is needed to make financial management and control in the government a reality.

5.2 The government has not significantly advanced its study of accrual-based budgeting and appropriations. The Treasury Board Secretariat continues to state that this complex issue requires extensive study before a decision can be made, even though the issue has been under examination for some time. In our view, resolution of this matter is needed to help make financial management and control in the government effective.

5.3 As of 1 April 2001, all departments and agencies have successfully implemented new financial systems capable of handling accrual financial information and submitting that information to the government's central systems for preparation of the summary financial statements. As we stated in our previous reports to Parliament, departments and agencies now need to improve the quality of their financial information that supports both departmental financial reporting and analysis and, ultimately, the preparation of the government's summary financial statements. They also need to ensure that appropriate internal controls are in place for their financial accounting and information systems.

5.4 The government's current model for departmental financial statements does not require recording and disclosure of some significant costs and liabilities. In our view, without this information, the financial statements do not provide accurate and reliable information on departments' program costs and financial positions. We encourage the government to resolve the outstanding concerns about departmental financial statements and to establish a target date for finalizing auditable departmental financial statements.

5.5 Financial management and control is vital for achieving results for Canadians. It involves the use of financial and non-financial information in decision making, and the effective implementation of financial information systems and controls. The Office of the Auditor General of Canada fully supports the government's implementation of improved financial management and control practices, including the adoption of full accrual accounting.

5.6 However, making financial management and control in government more effective involves more than simply preparing financial information or implementing financial systems. A change in the way financial information is used must occur at all levels within the government to ensure that financial management and control is an integral part of government operations and decision making.

5.7 The Comptroller General of Canada needs to lead this change by

- building on the momentum created by the importance and priority assigned to the Comptrollership Modernization Initiative by the Clerk of the Privy Council,
- aggressively advancing financial management and control within government so that the environment for change can be improved, and
- developing a strategy to increase the representation of professional accountants in the positions of senior financial officer and senior full-time financial officer.

Background and other observations

5.8 Accrual accounting refers to an underlying basis of accounting used to record the financial transactions of an entity. Accrual accounting recognizes transactions and other events when they occur, rather than when cash or its equivalent is received or paid. Expenses are recorded in the period when the goods or services are consumed, revenues are recorded in the period to which they pertain, and the multi-year benefits associated with long-lived assets are matched to the time when they are expected to be used.

5.9 Accrual financial information helps users appreciate the full scope of government—the resources, obligations, financing, costs, and impacts of its activities, including the costs of consuming assets over time. This more complete picture enables legislators to hold the government more accountable for the stewardship of its assets, the full costs of its programs, and its ability to meet short-term and long-term financial obligations.

5.10 Accrual financial information can also help improve decision making within departments. Managers will improve their focus on the stewardship of assets and liabilities under their control, consider the full costs of providing services, and examine how the full range of costs might affect their use of public funds.

5.11 In the 2001 Budget, the government stated that it had decided to delay implementation of full accrual accounting for its summary financial statements for at least one year. The government made this decision because accrual financial information was not available to allow consideration of the impact of implementation on the Budget, and because important components of the information required for implementing full accrual accounting had not been verified and audited. We encourage the government to resolve concerns that are causing delays in introducing full accrual accounting for its summary financial statements, including the processes for determining management estimates, and to implement it for the year ending 31 March 2003.

The Treasury Board Secretariat has responded. The Secretariat has indicated the actions it has taken or intends to take to address the recommendations. Its detailed response follows each recommendation throughout the chapter.

Statistics Canada
Managing the Quality of Health Statistics

Chapter 6

Main Points

6.1 Good-quality statistics are fundamental to an informed public debate on health issues. Statistics Canada is one of the key providers of health statistics. It has put in place a wide range of systems and practices to build quality into its statistical programs and to ensure that data quality remains a priority. Our audit found that Statistics Canada's data quality assurance systems and practices are sound and that the Health Statistics Division applies these to its health statistics programs. This has resulted in statistics that meet the Agency's data quality standards. We found that the health statistics produced by Statistics Canada for the September 2002 federal, provincial, and territorial health indicators reports are sufficiently accurate for this use.

6.2 Because Health Statistics Division's surveys are under its direct control, the Division makes necessary improvements to maintain data quality when the need arises. In co-operation with the organizations that provide administrative data to Statistics Canada, the Division is leading work to maintain and improve the quality of the data. We concluded that, with the exception of one database, Statistics Canada's quality assurance systems and practices adequately ensure the quality of its health statistics.

Background and other observations

6.3 Current attention to health issues includes a focus on developing health indicators that measure the health status and health outcomes of Canadians. The Communiqué on Health from the September 2000 First Ministers' Meeting included a commitment for governments to report regularly on health indicators, beginning in September 2002.

6.4 Our audit focussed on databases and surveys that provided data for these reports. At the federal level, the two main organizations involved in collecting health statistics are Statistics Canada and Health Canada. Most of the data came from Statistics Canada, with some from Health Canada and the rest provided by the Canadian Institute for Health Information (CIHI) and by the provinces and territories.

6.5 Statistics Canada's Health Statistics Division has a mandate to provide accurate, timely, and relevant information about the health of Canadians and the health care system. The Division works to ensure that its health statistics meet Statistics Canada's data quality standards. It is responsible for vital statistics (births, deaths), cancer data, data for indicators on health outcomes, and health surveys.

6.6 All statistics are, to some extent, estimates of the reality they seek to convey. Therefore, they have to be used with a sound understanding of their strengths and limitations. However, the Health Statistics Division's application of Statistics Canada's policy on informing users of data quality and methodology is inconsistent. While Statistics Canada has established a single database for informing users on data quality, the information in the database is not complete. The Agency needs to develop an approach to help all program managers maintain current, complete information in the database.

6.7 It is important that the Division determine the quality of data it receives from other organizations so it knows to what extent these data can be relied on for their intended use. The Division receives data from the CIHI Hospital Morbidity Database that it uses to construct indicators on patient outcomes; however, the Division did not make a formal determination of data quality. We also found that the Agency did not formally monitor the accountability requirements of the Health Information Contribution Program. The Program's contribution agreement provides funding for the statistical databases that Statistics Canada transferred to CIHI, including the Discharge Abstract Database. This has implications for maintaining the quality of the transferred databases. We concluded that, with the exception of this database, the Health Statistics Division has quality assurance systems and practices to adequately ensure the quality of its health statistics.

6.8 Health Canada produces health statistics through national surveillance systems. These systems collect data on communicable and chronic diseases and injuries. Three of these systems provided data for the September 2002 health indicators reports. However, the quality assurance systems and practices for these databases do not ensure the accuracy of the data. Therefore it was not possible to form an opinion on the accuracy of these data. Improvements in these processes are needed.

6.9 Health Canada is also responsible for monitoring funding provided to CIHI under the Health Information Roadmap Initiative. We found that the Department does not actively monitor this initiative in accordance with the grant's requirements. As a result, it has no formal basis for knowing whether the Initiative's intended objectives are being achieved.

6.10 CIHI's Discharge Abstract Database and Hospital Morbidity Database provided data for several of the indicators in the September 2002 health indicators reports. Audit work led by the Office of the Auditor General of British Columbia found that documentation on the quality assurance process for the systems that provide the data is inadequate. As well, a three-year study that will provide information on the quality of the input data will not be completed for another two years. Therefore, it was not possible to form an opinion on the accuracy of the specific data provided by CIHI for the health indicators reports.

Statistics Canada and Health Canada have responded. Statistics Canada and Health Canada agree with our recommendations. However, Health Canada considers that our chapter does not acknowledge the substantial flow of information to Health Canada from the Canadian Institute for Health Information. Both entities have indicated in their responses that a number of actions are under way to deal with our recommendations.

Canadian Space Agency
Implementing the Canadian Space Program

Chapter 7

Main Points

7.1 The Canadian Space Agency needs to develop a new strategic plan that can help it balance the activities required of it under the Canadian Space Program and its annual funding level. Currently, it is unable to meet the expectations for the Space Program fully because of financial obligations that the government incurred in the past and that extend into the future; to some extent the Agency's own process of setting priorities is also responsible. The current imbalance between activities required under the Canadian Space Program and the Agency's financial capacity is likely to worsen in the next five years.

7.2 The Agency has only partially assessed the shortfall in its capacity to deliver the Canadian Space Program, and it needs to inform the government of the gaps in its ability to meet the Program's objectives.

Background and other observations

7.3 The Space Program Management Framework is lacking some key elements that are required under the Canadian Space Program, including stakeholder participation in setting priorities, strategies, and plans for the Agency's five key service lines. As a result, the Agency is making strategic decisions that affect the funding of the service lines without the benefit of input from the advisory structure approved by the government, although it has held informal consultations with key stakeholders.

7.4 The Agency's project and risk management practices are generally sound in projects over which it has prime responsibility and control. However, in two major Crown projects it has been unable to escape the negative effects of program slippage, cost escalation, and unilateral decisions by international partners. For example, the three-year delay of the launch of Canada's third component for the International Space Station (ISS) will cost the Agency about $13 million to maintain that component's full operational capability; and the withdrawal of the National Aeronautics and Space Administration (NASA) from the launch arrangement resulted in a delay of more than two years and additional costs of $167 million for the Agency's RADARSAT-2 project. In addition, a projected cost overrun of US$5 billion in the ISS program by NASA caused the United States Congress to impose a temporary budget cap of US$25 billion while NASA corrects its program management practices. If this cap is maintained, it threatens to severely limit Canada's ability to conduct the research for which it has invested in the program.

7.5 The Agency enjoys a strong reputation for excellence. Although it is not a large organization, its programs are highly visible nationally and internationally. They are a source of national pride for most Canadians and have earned Canada worldwide recognition in the space industry.

7.6 There is an urgent need for the Agency to develop a strategic human resources plan. Although senior managers are aware of their short-term needs, a human resources committee has yet to be established and made responsible for developing a comprehensive human resources plan that links the needs of directorates to operational plans and strategic objectives. The Agency is currently increasing its indeterminate workforce significantly while reducing its reliance on term employees and contract workers. However, it has not aligned its present competencies with the projects it has planned for the short and the long terms to identify clearly the additional resources it needs.

7.7 The Agency does not have all the necessary processes to report on its performance. It has developed few performance indicators by which to measure its progress toward desired strategic outcomes. Currently, in reporting to Parliament, the Agency arbitrarily matches the strategic outcomes with consolidated information from the reports of its directorates.

The Agency has responded. The Canadian Space Agency has generally agreed with our recommendations. Actions it has under way or planned are set out in its response to each recommendation in the chapter.

Public Works and Government Services Canada

Acquisition of Office Space

Chapter 8

Main Points

8.1 The Real Property Services Branch of Public Works and Government Services Canada (PWGSC) still faces some strategic planning, management, and reporting challenges. For example, it still lacks key planning tools. Without regional plans and consistent national information on the supply of space, it is difficult to match available space with the needs of client departments; management of the Branch recognizes that this affects its strategic planning ability. Further, while the Branch has the basic infrastructure for a reasonable system of performance management, it needs to improve its reporting to Parliament on what it expects to achieve and what it has achieved.

8.2 The Branch needs to make better use of financial and operational information and improve the way it analyzes options, particularly those with longer-term implications. It has difficulty accessing cost information and needs to do more work on creating cost information by client. Because investment in real estate involves large sums of capital and large lease payments, it requires a long-term perspective. The Branch needs to consider fully all practical alternatives, including the full costs of each. Good information and full analysis of options are needed to deliver service effectively to client departments and agencies.

Background and other observations

8.3 Providing office accommodation for the federal public service is a complex and difficult task. The Real Property Services Branch of Public Works and Government Services Canada has developed a good framework for managing the office accommodation of most of 187,000 public service employees, for which it has annual funding of about $1.7 billion.

8.4 Because it shares roles and responsibilities with client departments, the Branch does not control all the factors that affect the economy and efficiency of office space acquisition. Client departments can and do make decisions that limit the Branch's ability to adopt what it believes are the most cost-effective solutions. However, the Real Property Services Branch does have an important role to play, and it needs to improve the way it manages several aspects of its responsibility.

8.5 The Branch has had to adjust to changes in the public service—which went from downsizing in the 1990s to expansion in 2001—and take into account the availability of space vacated by the high-technology sector in the National Capital Region.

8.6 In 1991 and 1994, we reported that improvements were needed to obtain information on client requirements in a timely way and to develop long-term accommodation plans.

8.7 The Branch has begun to take a more proactive approach by looking at a portfolio of owned and leased buildings in a given area and forecasting the needs of all clients, rather than meeting needs client by client. According to client departments and Branch staff, it has improved its service delivery by establishing client service units as a single point of contact for client departments.

8.8 Although it has made some improvements in planning and management, the Branch faces long-standing challenges. It is important that it resolve them, given the significant level of resources it spends on office accommodation and its key role in supporting departments and agencies that deliver programs to Canadians.

The Department has responded. Public Works and Government Services Canada has agreed with our recommendations. Plans and actions it has under way are indicated in its responses in the chapter.

Modernizing Accountability in the Public Sector

Chapter 9

Main Points

9.1 This chapter proposes an enhanced definition of accountability that takes modern developments in public management and governance into account:

> Accountability is a relationship based on obligations to demonstrate, review, and take responsibility for performance, both the results achieved in light of agreed expectations and the means used.

9.2 This definition of accountability is consistent with managing for results, allows for accountability among partners who might be equal and or independent, and includes obligations for all parties in the accountability relationship. It emphasizes the importance of accountability for results and for the means used. It underlines that effective accountability is not just reporting performance; it also requires review, including appropriate corrective actions and consequences for individuals.

9.3 In addition, we outline five principles of effective accountability: clear roles and responsibilities; clear performance expectations, a balance of expectations with capacities; credible reporting; and reasonable review of performance, with adjustment. These principles can be applied to a wide range of accountability relationships, but their use needs to be tailored specifically to each relationship.

9.4 Accountability would be strengthened if Parliament played a more active role in scrutinizing the government's plans and performance expectations and comparing them with the performance reported later by the government.

9.5 Transparency is essential to accountability, making it easier for those outside government to monitor and challenge the government's performance for consistency with policy intentions, for fairness, for propriety, and for good stewardship. The prospect of scrutiny also helps keep ministers and managers of public programs (public servants as well as their partners in program delivery) attuned to the defensibility of their actions.

Background and other observations

9.6 In our representative democratic system, accountability legitimizes the government's right to govern. Parliament holds the government to account for the legitimate use of authority. Ministers are held to account in Parliament, and they, in turn, hold their officials to account for the delivery of public policy.

9.7 Traditional accountability practices are under pressure by developments in public management and governance—a focus on getting results, using partnering arrangements, and developing a flexible and innovative public service.

9.8 Just what can ministers and managers reasonably be held to account for, when managing is focussed on results—and in particular on outcomes, over which control and influence are limited? We think they can reasonably be held accountable for demonstrating the extent to which the results they expect are being accomplished, the contribution their activities have made to the actual outcomes, the lessons that have been learned, and the soundness and propriety of their actions.

9.9 In partnering arrangements—used increasingly by governments to deliver public programs—accountability can become diffused. In our view, these arrangements require more and not less accountability. Each partner is accountable not only to its own superior or governing body but also to the other partners in the arrangement. Together, they are accountable to their joint co-ordinating body or, in some cases, to the public for the arrangement's operation and success.

9.10 A degree of discretion and flexibility allows managers of public programs to take reasonable risks in order to innovate. If it is based solely on compliance with too many and unneeded rules and procedures, accountability cannot easily incorporate risk. Accountability must be able to tolerate mistakes or adverse results, provided that any risk taken can be shown to have been reasonable and the management of the risk to have been sound.

The government has responded. The response of the Treasury Board Secretariat on behalf of the government is included at the end of the chapter. The government welcomes the ideas in the chapter as consistent with recent government initiatives. It stresses the need to tailor the application of any principles to individual circumstances. The government welcomes the opportunity to continue the dialogue on accountability.

Department of Justice

Costs of Implementing the Canadian Firearms Program

Chapter 10

Main Points

10.1 The Department of Justice Canada did not provide Parliament with sufficient information to allow it to effectively scrutinize the Canadian Firearms Program and ensure accountability. It provided insufficient financial information and explanations for the dramatic increase in the cost of the Program.

10.2 In 1995 the Department told Parliament that the Canadian Firearms Program would cost $119 million to implement, which would be offset by $117 million in fees. We requested the Department provide us with information on Program costs and revenues for the period 1995–96 to 2001–02. The information the Department provided states that by 2001–02 it has spent about $688 million on the Program and collected about $59 million in revenues after refunds. We believe that this information does not fairly present the cost of the Program to the government.

10.3 In 2000, the Department of Justice estimated that by 2004–05 it would spend at least $1 billion on the Program and collect $140 million in fees after refunds. This amount does not include all financial impacts on the government. The Department also did not report to Parliament on the wider costs of the Program as required by the government's regulatory policy.

10.4 The Department has offered many reasons for the cost escalation, including major delays in making regulations, provinces opting out of the Program, the need for additional initiatives, incorrect assumptions about the rate it would receive applications for licences and registrations, and an excessive focus on regulation and enforcing controls.

10.5 Complete and accurate financial information and explanations on Program costs and revenues should have been reported to Parliament annually in the Department's Report on Plans and Priorities and in its Departmental Performance Report. These formal documents are intended to provide information to Parliament in order to allow it to scrutinize departmental expenditures.

10.6 The Department of Justice should provide Parliament annually with complete and accurate information on all past, current, and forecasted expenditures and revenues relating to the Program; and it needs to disclose and explain any major changes in the Program.

Background and other observations

10.7 Under the 1995 *Firearms Act* the Department is responsible for the Canadian Firearms Program. This legislation requires that all owners and users of firearms be licensed by 1 January 2001 and that all firearms be registered by 1 January 2003. The federal government estimates that the total number of firearms owners is 2.46 million and the total number of firearms is 7.9 million.

Federal agencies have responded. Department of Justice Canada acknowledges that implementing this program across Canada was a significant logistical, technical, and management challenge. It states that in the interest of public safety, and in response to recommendations from the public and Parliament, changes were made to the initial program design that increased the design of the system and its cost.

The Treasury Board Secretariat notes that the Department of Justice faced significant challenges in implementing a program of this magnitude and originality. It also notes that it was always understood that original estimates would be revised in response to the demands of program implementation.

Other Audit Observations

Chapter 11

Main Points

11.1 This chapter fulfils a special role in the Report. Other chapters normally report on value-for-money audits or on audits and studies that relate to operations of the government as a whole. Other Audit Observations discusses specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations, and other entities, or during our value-for-money audits or audit work to follow up on third-party complaints. Because these observations deal with specific matters, they should not be applied to other related issues or used as a basis for drawing conclusions about matters not examined.

11.2 During a hearing this year, the Standing Committee on Public Accounts requested that we continue to bring to Parliament's attention previous observations that have not been resolved. In this report, four of the audit observations were previously reported and have been indicated as such.

11.3 This chapter covers new issues:

- Executive compensation in Crown corporations—Compensation needs to be more transparent.
- Royal Canadian Mounted Police—Canadian Firearms Program—Information to screen applicants for firearms licences may not be accurate.
- Indian and Northern Affairs Canada—The food mail program: A key component of this program has never been fully reviewed.

11.4 The chapter also covers issues previously updated:

- Department of Finance—Tax arrangements for foreign affiliates have eroded Canadian tax revenues of hundreds of millions of dollars over the last 10 years.
- Park Downsview Park Inc.—An urban park is being created without formal approval by Parliament.
- Atomic Energy of Canada Limited—The government has approved Atomic Energy of Canada Limited's five-year corporate plan for the first time since 1994–95.
- Employment Insurance Account—No explanation was provided to Parliament for a surplus reaching $40 billion.

Report of the Auditor General of Canada to the House of Commons—December 2002

Main Table of Contents

Matters of Special Importance—2002
Foreword and Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada—Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada—Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

Appendices

2002

Report of the
Auditor General of Canada
to the House of Commons

DECEMBER

Chapter 1
Streamlining First Nations
Reporting to Federal Organizations

Office of the Auditor General of Canada

The December 2002 Report of the Auditor General of Canada comprises 11 chapters, Matters of Special Importance—2002, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

Ce document est également disponible en français.

© Minister of Public Works and Government Services Canada 2002
Cat. No. FA1-2002/2-9E
ISBN 0-662-33107-9

Chapter

1

Streamlining First Nations Reporting to Federal Organizations

Table of Contents

Main Points 1

Introduction 3

Reporting requirements are of recent origin 3
Reporting requirements have evolved 3
Communities are diverse 3
Focus of the study 3

Observations and Recommendations 5

The nature of the reporting system 5

Funding agreements set requirements 5
Funding agreements have evolved 6
Several types of reports are required 7
A large number of reports are required 7

First Nations perspectives 8

Communities develop reporting procedures 8
Some communities have developed internal financial reporting 8
Communities carry on formal and informal non-financial reporting 10
Communities are strongly critical of the federal reporting system 11
Managing the reports is a challenge 14
Tribal councils are responding to the challenge 14

Federal organizations—Reporting process 15

Requirements need to be reviewed 15
Required reports are tracked, but most are submitted on hard copy 17
Financial reports are generally verified and reviewed 18
Communication with First Nations is inadequate 18
Performance information is insufficient 19
Health Canada is developing performance measures 20
Information for Parliament about First Nations needs to be improved 20
There is a need for better co-ordination 20

A way forward 21

Conclusion 22

About the Study 24

Appendices

A. First Nations required reporting to selected federal organizations 25
B. Information from First Nations reported to Parliament 45

Streamlining First Nations Reporting to Federal Organizations

Main Points

1.1 First Nations reporting requirements established by federal government organizations are a significant burden, especially for communities with fewer than 500 residents. We estimated that at least 168 reports are required annually by the four federal organizations that provided the most funding for major federal programs.

1.2 We found overlap and duplication among the required reports. With the exception of some financial reports, limited use is being made of the reports by the federal organizations sampled, and we suggest that fundamental change is required. We found the following:

- Reporting requirements are dictated, not based on consultation.
- The information reported is generally not used to set funding levels.
- The reports contain information that does not reflect community priorities.
- We noted that new reports are being introduced with little or no review of the reporting requirements for existing programs, adding to the reporting burden.
- There is little feedback to the First Nations, except for an analysis of audited financial statements.
- Most required reports for Indian and Northern Affairs Canada (INAC) and Health Canada do not provide adequate information on performance or results.
- Little of the information being collected from the First Nations is being used by a number of the federal organizations in their reports to Parliament.

1.3 We are concerned about the burden associated with the federal reporting requirements. Resources used to meet these reporting requirements could be better used to provide direct support to the community. Steps need to be taken to streamline reporting requirements. The current program structure established by the federal organizations is an obstacle to reforming reporting requirements and needs to be reviewed.

Background and other observations

1.4 The reporting relationship between the First Nations and the federal organizations has evolved significantly over the last few decades. Today, communities deliver programs and services and administer annual budgets that can be in the millions of dollars. This has increased the reporting requirements within the communities and from the communities to federal organizations.

1.5 The study reported here focussed on the reporting requirements of funding agreements between the federal government and First Nations. Although the Auditor General is not the auditor of First Nations, we wanted to reflect their perspectives. The Federation of Saskatchewan Indian Nations assisted us and as a result, four First Nations and two tribal councils in Saskatchewan volunteered to participate in the study.

1.6 Our study was not intended to provide a complete view of national reporting. However, as the same reports are required in every region of the country, the study does shed light on issues that are relevant across Canada. It also suggests criteria for reporting.

The federal government has responded. The government's response is included at the end of the chapter. The government agrees with the recommendations in the study, and accepts the desire to reduce the reporting burden on First Nations.

Introduction

Reporting requirements are of recent origin

1.7 First Nations have undergone a significant evolution in their reporting relationship with federal organizations over the last few decades. As recently as 1968, Indian agents played a key role in First Nations communities as the official spokespersons for Indian and Northern Affairs Canada (INAC). The chief and council were not responsible for program delivery, and First Nations did not report to federal organizations; those responsibilities were handled by the Indian agent.

1.8 The situation has changed significantly. Chiefs and councils have assumed increasing responsibility for program delivery. Today, communities deliver the programs and administer annual budgets that can be in the millions of dollars.

We were told by one member of a community how, as a child, in the mid-1960s her father took her by the hand, walked up to a cottage located in the community, and stood in a long line to receive the monthly family rations from the Indian agent. Today, that same community has investments and assets in excess of $100 million, revenues in excess of $42 million, and expenses of $30 million (31 March 2001).

Reporting requirements have evolved

1.9 For some communities, block funding arrangements on a multi-year basis have increased their autonomy and provided flexibility in the delivery of programs. Multi-year funding has consolidated reporting requirements for some programs, from a monthly to an annual basis.

1.10 In the last few years, the number of federal programs that provide support to First Nations has increased. Each new program has generated additional reporting. In addition, recent concerns about the adequacy of controls over public expenditures, particularly grants and contributions, have led federal organizations to take steps to increase controls. Taken together, these factors have resulted in increased reporting requirements.

Communities are diverse

1.11 It is important to note the circumstances in which federal programs are delivered in First Nations communities. Communities vary in size. The majority (61 percent) have fewer than 500 residents. Many of the communities (20.7 percent) are located in isolated and remote areas which affects the delivery of key services such as health care and education. In addition, each community is distinct in terms of its culture, degree of economic development, and the types and levels of services required.

Focus of the study

1.12 This is the first study undertaken as part of the Auditor General's priority on Aboriginal issues. It examines reporting requirements associated with funding agreements between federal organizations and First Nations, the purposes of reporting, and—recognizing the importance of good reporting for good management—ways to improve current practice. We started with the First Nations communities, looking at issues from their perspective, followed by a review of the systems and practices in the applicable federal organizations.

1.13 The objectives of the study were

- to assess reporting and audit requirements,
- to examine the use of reports and audits, and
- to develop criteria for an effective reporting system.

1.14 The Auditor General is not the auditor of First Nations. Our mandate is to audit federal departments, agencies, and the Crown corporations that, in turn provide support for First Nations. However, in this study, we needed the co-operation of a number of First Nations to learn about the reporting first-hand and to talk to those most directly affected.

1.15 The Federation of Saskatchewan Indian Nations (FSIN) offered to assist us, which led to four First Nations in Saskatchewan volunteering to participate in this study. Two are multi-community First Nations. Each of these First Nations has a significantly different relationship with the federal government. Two communities were managing their own affairs and two were managed by a third party with one federal department; this means that the programs delivered to them were under trusteeship and managed by a third party independent of the community. We also included two tribal councils in the study, because of their role in delivering health, education, and other services, through agreements with the federal government.

1.16 We examined the four federal organizations that provided the largest amount of funding to First Nations for program development and delivery. These organizations accounted for 95 percent of federal funding to First Nations in 2000–01. In order of size of spending, they were: Indian and Northern Affairs Canada (68 percent), Health Canada (18 percent), Human Resources Development Canada (5 percent), and Canada Mortgage and Housing Corporation (4 percent). We met with officials of these four organizations at their headquarters in the National Capital Region, and in local and regional offices in Saskatchewan. Exhibit 1.1 shows the program areas included in the study.

1.17 The study is not intended to provide a complete view of national reporting. However, given that the same reports are required in every region of the country, the study does shed light on issues that are relevant across Canada. In addition, we sought to identify good practices that would apply generally to communities in other regions of the country.

1.18 As we were completing the study, the Minister of Indian and Northern Affairs tabled an act "respecting leadership selection, administration and accountability of Indian bands, and to make related amendments to other Acts." This act could change the way First Nations are required to report; however, it did not form part of our discussions with First Nations and is not considered in this study. Also not considered in the study, but related to reporting, is a proposal to establish four public institutions, including a First Nations Statistical Institute that is intended to assist First Nations in meeting their information needs.

1.19 Further details on the study are found at the end of the chapter in About the Study.

Observations and Recommendations

The nature of the reporting system

Funding agreements set requirements

1.20 Both specific statutes, including the *Indian Act* and other federal legislation, and government policies incorporated into funding agreements with First Nations require First Nations to report to federal organizations.

1.21 The agreements are quite standard, based on templates and funding is distributed by formulas rather than negotiated individually. The agreements typically supply the funds for a specified time period and specific program purposes, and attach various conditions, including the minister's right to intervene and the reporting requirements.

Exhibit 1.1 Program areas included in the study

Organization	Program areas	Description of programs
Indian and Northern Affairs Canada	Indian registration	Reports to the Department on births, deaths, and other events related to the registering of persons with Indian status.
	Education	Provides funding for all levels of education from elementary to post-secondary, including special education and life-long learning.
	Social development	Provides funding through First Nations to individuals and families for a variety of social programs.
	Indian government support	Provides funding for the structures that govern the communities and tribal councils.
	Capital	Provides funding support for community infrastructure, such as water and sewer services, roads, bridges, the construction and renovation of houses, and major capital projects.
	Economic development	Assists in the process of community economic development, general business assistance, and resource-based opportunities.
Health Canada	Home and Community Care	Implements or enhances home and community care. This comprises a range of services that responds to the unique health and social needs of First Nations.
	Aboriginal Head Start on Reserve	An early intervention strategy that addresses the needs of First Nations children up to the age of six, who live in First Nations communities.
	Aboriginal Diabetes Initiative	Addresses the epidemic of diabetes among Aboriginal people in three main areas: care and treatment, prevention and promotion, and lifestyle support.
	Tuberculosis Elimination Strategy	Works to prevent and control tuberculosis in First Nations communities.
Human Resources Development Canada	Aboriginal Human Resources Development Strategy	Enables Aboriginal organizations to assist clients to prepare for, obtain, and maintain employment.
Canada Mortgage and Housing Corporation	Section 95, *National Housing Act*, Assisted Housing	Assists First Nations to construct, buy, and renovate suitable and affordable houses for rent on-reserve.

Source: Canada Mortgage and Housing Corporation, Health Canada, Human Resources Development Canada, and Indian and Northern Affairs Canada

Observations and Recommendations

Funding agreements set requirements

1.20 [illegible]

1.21 [illegible]

Exhibit 1.1 Program areas included in the study

Organization	Program areas	Description of programs
Indian and Northern Affairs Canada	Indian registration	Reports to the Department on births, deaths, and other events related to the registering of persons with Indian status.
	Education	Provides funding for all levels of education from elementary to post secondary, including special education and life-long learning.
	Social development	Provides funding through First Nations to individuals and families for a variety of social programs.
	Indian government support	Provides funding for the structures that govern the communities and tribal councils.
	Capital	Provides funding support for community infrastructure, such as water and sewer services, roads, bridges, the construction and renovation of houses, and major capital projects.
	Economic development	Assists in the process of community economic development, general business assistance, and resource-based opportunities.
Health Canada	Home and Community Care	Implements or enhances home and community care. This comprises a range of services that responds to the unique health and social needs of First Nations.
	Aboriginal Head Start on Reserve	An early intervention strategy that addresses the needs of First Nations children up to the age of six, who live in First Nations communities.
	Aboriginal Diabetes Initiative	Addresses the epidemic of diabetes among Aboriginal people in three main areas: care and treatment, prevention and promotion, and lifestyle support.
	Tuberculosis Elimination Strategy	Works to prevent and control tuberculosis in First Nations communities.
Human Resources Development Canada	Aboriginal Human Resources Development Strategy	Enables Aboriginal organizations to assist clients to prepare for, obtain, and maintain employment.
Canada Mortgage and Housing Corporation	Section 95, *National Housing Act*, Assisted Housing	Assists First Nations to construct, buy, and renovate suitable and affordable houses for rent on-reserve.

[illegible]

1.22 The funding agreements generally take the form of contribution agreements—a type of transfer agreement subject to controls at the departmental and central agency levels. Treasury Board policy governs the way departments make these payments, and how they are accounted for and audited. External audits are not mandatory under the policy, but when financial audits are required under contribution agreements, they are to be conducted in accordance with generally accepted auditing standards. Essentially, under these agreements, First Nations are held accountable for spending the money to achieve the purposes intended. They may also be subject to departmental audit to verify those expenditures. Agreements with First Nations provide funds for program expenditures (for education, housing, and community health and social programs); for some programs, adjustments are made to reimburse First Nations for money spent for specific purposes (for example, social assistance, special education, Indian Child and Family Services).

1.23 In Saskatchewan the federal organizations have determined funding for some programs on a province-wide basis but may involve the Federation of Saskatchewan Indian Nations in the management of the programs, as in HRDC labour market programs. The Canada Mortgage and Housing Corporation also involves the Federation in the allocation of resources for housing.

Funding agreements have evolved

1.24 Funding agreements have evolved in recent years.

- INAC's stated intention has been to move toward agreements that provide greater flexibility for First Nations, for example by allowing multi-year funding and the application of a surplus in one program to be moved to cover expenditures in another program.
- During the 1990s, Health Canada was also moving to promote greater flexibility through five-year transfer agreements. Recently, however, it undertook a major revision of its agreements with First Nations. For example, the year-end due date for audited financial statements was extended from 90 to 120 days. In addition, consolidated transfer agreements have been changed to add additional control features.

1.25 In the four communities we visited, we found that one has a five-year transfer agreement with INAC (Financial Transfer Arrangement), and another has an annual agreement with INAC (Comprehensive Funding Arrangement). In the other two communities, the annual agreement for the delivery of their INAC programs was between the third-party manager and INAC. Three of the communities had multi-year agreements with Health Canada (Consolidated Contribution Agreement [Transfer/Targeted Programs]); the other community's tribal council had the same form of agreement. All of the communities had project-operating agreements with CMHC for subsidies and loans guaranteed by INAC, for the construction, purchase, or renovation of homes.

Several types of reports are required

1.26 The non-financial and financial reports required by federal organizations can be grouped as set out in Exhibit 1.2 which provides examples of each type of report (see Appendix A for additional information). We included reports that support funding proposals, whether the proposals are for one-time funding or in support of ongoing programs. We also included budgets and cash flow statements for new programs, because First Nations provide the data required for them. The federal organizations provide First Nations with funding to prepare the required reports.

A large number of reports are required

1.27 We estimated that 202 reports are required annually in a community for the selected programs of the four federal organizations in our study, including reports required under INAC annual agreements (comprehensive

Exhibit 1.2 Examples of types of reports that must be completed by First Nations

Type	Federal organization	Report	Description
		Non-financial reports	
Plan	Indian and Northern Affairs Canada (INAC)	Five-year Housing Plan	Sets out the revenues and expenditures for housing by year and source of funding support (INAC, CMHC, Band funds, etc.).
Support for proposals	Canada Mortgage and Housing Corporation (CMHC)	Environmental reports	These reports are required in support of rental housing proposals involving more than six units to determine if there is contamination such as chemicals, on the sites being considered for housing units.
Activity	INAC	Adult Care Monthly Report (an annual report in five-year agreements)	Provides information on the client who was served, the type of care received, and the nursing hours involved.
Census	INAC	Post-secondary education	The annual census reports on the numbers of students funded, the institutions they attend, and related information.
Monitoring	Human Resources Development Canada (HRDC)	Monitoring reports	Compiles the observations and recommendations that result from a visit by personnel from the Saskatchewan Indian Training Assessment Group Inc. to First Nation management areas. It covers matters such as financial claims, Employment Insurance activities, and capital assets.
Evaluation	INAC	Five-year school evaluations	A review of the education program in First Nation-operated schools is required every five years.
		Financial reports	
External audited financial statements	INAC	First Nations external audited financial statements	External auditors, appointed by the chief and council, audit the financial statements and report directly to them.
Other financial reports	Health Canada	Budgets and cash flow statements for new contribution programs	Generally a one-page statement covering the period of the contribution agreement for each program.

Source: Canada Mortgage and Housing Corporation, Health Canada, Human Resources Development Canada, and Indian and Northern Affairs Canada

Several types of reports are required

1.26 [illegible]

A large number of reports are required

1.27 [illegible]

Exhibit 1.2 **Examples of types of reports that must be completed by First Nations**

Type	Federal organization	Report	Description
		Non-financial reports	
Plan	Indian and Northern Affairs Canada (INAC)	Five-year Housing Plan	Sets out the revenues and expenditures for housing, by year and source of funding support (INAC, CMHC, Band funds, etc.).
Support for proposals	Canada Mortgage and Housing Corporation (CMHC)	Environmental reports	These reports are required in support of rental housing proposals involving more than six units to determine if there is contamination such as chemicals on the sites being considered for housing units.
Activity	INAC	Adult Care Monthly Report (an annual report in five-year agreements)	Provides information on the client who was served, the type of care received, and the nursing hours provided.
Census	INAC	Post-secondary education	The annual census reports on the numbers of students funded, the institutions they attend, and related information.
Monitoring	Human Resources Development Canada (HRDC)	Monitoring reports	Compiles the observations and recommendations that result from a visit by personnel from the Saskatchewan Indian Training Assessment Group Inc. to First Nation management areas. It covers matters such as financial claims, Employment Insurance activities, and capital assets.
Evaluation	INAC	Five-year school evaluations	A review of the education program in First Nation-operated schools is required every five years.
		Financial reports	
External audited financial statements	INAC	First Nations external audited financial statements	External auditors, appointed by the chief and council, audit the financial statements and report directly to them.
Other financial reports	Health Canada	Budgets and cash flow statements for new contribution programs	Generally a one-page statement covering the period of the contribution agreement for each program.

[illegible]

funding arrangements). The number falls to 168 by virtue of the reduced reporting requirements under INAC multi-year agreements (financial transfer arrangements). The results are summarized in Exhibit 1.3. These estimates are based on funding agreements in Saskatchewan and supporting documentation from federal organizations; the actual number of reports filed by individual First Nations may vary. The estimate is understated because we did not count reports for all programs of the four organizations, or those required by other federal organizations that also provided support to Aboriginal peoples.

First Nations perspectives

Communities develop reporting procedures

1.28 In the reporting system, the flow of information is from First Nations to federal organizations. The First Nations we talked to, found that the reporting requirements were not well suited to helping them to manage their own affairs, particularly where they had developed governance structures that include reporting procedures.

1.29 In the four First Nations we visited in Saskatchewan, the chief and council, as elected officials, delegate portfolio responsibilities in areas such as health and housing to committees chaired by a council member and composed of community members.

1.30 In one smaller community we noted five such committees. Anyone from the community is welcome to sit on these committees, which report back regularly to the council. Councillors who are responsible for a particular area or portfolio are directly involved with staff in administration and management of the programs. Another larger community established 12 portfolios; each portfolio is held by a councillor, and managed by a program director. In that community, administration is separate from the role of elected officials, and is governed by its financial management act.

Some communities have developed internal financial reporting

1.31 The two communities that are not managed by a third party have developed procedures for internal financial reporting. This financial reporting is tied to their budget process. They have appropriate accounting software and are organized to review and report on financial information. For example, in one community, general ledger reports are sent to the executive director for review before being forwarded to the chief and council. Over the course of the year, staff report on differences, or variances against budget. The chief and council monitor the overall budget and services provided, and approve financial transactions.

1.32 Both communities have a good working relationship with the external auditors. Part of the budget process is an annual meeting with the membership where the chief and council present the audited financial statements.

Exhibit 1.3 Estimated annual number of required reports for federal programs examined

	Non-financial reports					Financial reports		
Federal programs	**Plans**	**Support for proposals**	**Activity**	**Census-type**	**Evaluation and monitoring**	**External audited financial statements**	**Other financial (budgets, cash flows)**	**Total number of reports**
Indian and Northern Affairs Canada (INAC)								
INAC – consolidated						1	1	2
Indian Registry System				26				26
Education			3	3	1		3	10
Social development		12	40 (6)*		1		24	77 (43)*
Indian government support		1	1					2
Capital	1		9				5	15
Economic development			4					4
INAC sub-total	1	13	57 (23)*	29	2	1	33	136 (102)*
Health Canada								
Transfer programs	1		1		1	1		4
Home and Community Care	1	1	4				3	9
Aboriginal Head Start on Reserve	1		3				1	5
Aboriginal Diabetes Initiative	1		4				3	8
Tuberculosis Elimination Strategy			22				12	34
Health Canada sub-total	4	1	34		1	1	19	60
Canada Mortgage and Housing Corporation (CMHC)								
Section 95, *National Housing Act*, Assisted Housing		2**	1		1	2		6
TOTAL	5	16	92 (58)*	29	4	4	52	202 (168)*

Exhibit 1.3 Estimated annual number of required reports for federal programs examined (continued)

Federal programs	Non-financial reports					Financial reports		
	Plans	Support for proposals	Activity	Census-type	Evaluation and monitoring	External audited financial statements	Other financial (budgets, cash flows)	Total number of reports
Human Resources Development Canada (HRDC)***								
Aboriginal Human Resources Development Agreements (AHRDA)	1		9****			****	5	15

[illegible]

Communities carry on formal and informal non-financial reporting

1.33 Reporting [illegible]

1.34 Community administrators [illegible] required by federal [illegible] example, monthly reporting [illegible] the portfolio consultant [illegible] find it helpful for program management [illegible] monthly reports prepared by [illegible] Resources Development Agreement with Human Resources Development Canada are used to help manage employment programs. [illegible] communities. For example, one community [illegible] how well the school was performing, as the basis for developing a school improvement plan.

Exhibit 1.3 Estimated annual number of required reports for federal programs examined (continued)

Federal programs	Non-financial reports					Financial reports		Total number of reports
	Plans	Support for proposals	Activity	Census-type	Evaluation and monitoring	External audited financial statements	Other financial (budgets, cash flows)	
Human Resources Development Canada (HRDC)***								
Aboriginal Human Resources Development Agreements (AHRDA)	1		9****			****	5	15

Notes:

*Numbers in parentheses refer to reporting requirements under INAC Financial Transfer Arrangements (multi-year). All other INAC requirements are for Comprehensive Funding Arrangements (annual).

**CMHC calls for housing proposals on a yearly basis. However, First Nations do not apply each year.

***HRDC reports are not included in the total because First Nation communities do not provide reports directly to HRDC. Local boards provide reports to the AHRDA holder, which in turn provides reports or electronic data to the Department.

****HRDC requires the AHRDA holder to submit an annual audit report, which is included in the annual report that is counted as an activity report in this table.

Source: Canada Mortgage and Housing Corporation, Health Canada, Human Resources Development Canada, and Indian and Northern Affairs Canada

Communities carry on formal and informal non-financial reporting

1.33 Reporting to community members both formally and informally in areas of priority programs is ongoing in the four communities we visited. The portfolio councillor and program manager report to the chief and council, who in turn generally report to the community membership in regular meetings. For example, in one community, the education policy calls for the director of education to report regularly to the chief and council. In another community, each school has a monthly reporting process to determine which children need help, and who should attend special needs classes. Another community has its own radio station, through which community leaders communicate with the membership on a wide range of issues.

1.34 Community administrators told us that some non-financial reports required by federal organizations were used in their reporting processes. For example, monthly reporting on social assistance is used in one community by the portfolio councillor to provide oral reports to the chief and council, who find it helpful for program management. Similarly, in another community, monthly reports prepared by local boards under the Aboriginal Human Resources Development Agreement with Human Resources Development Canada are used to help manage employment programs. Some evaluation reports required by federal organizations have also proven useful to communities. For example, one community used a school evaluation to gauge how well the school was performing, as the basis for developing a school improvement plan.

Communities are strongly critical of the federal reporting system

1.35 The First Nations told us that the required information generally does not reflect their priorities, and is not always useful to them. The reporting requirements are dictated to them, not determined through consultations. If the reports are not filed, then the community is at risk of not receiving the funds for the next period. Community leaders told us that, as the reporting often has no importance or consequences for program delivery, it encourages the practice of filing reports for the sole purpose of ensuring continued funding, in other words, "data for dollars". In addition, First Nations face many obstacles in compiling the reports, including poorly explained requirements, data that are often hard to collect, and inconsistent funding for report preparation. One chief told us that no-one knows why most of the reporting is done. Paragraphs 1.36 to 1.44 provide examples of these problems.

1.36 In education, the nominal roll, an annual head count, is used to determine the funding level for the community's education program. However, adjustments to funding levels are not made until the next fiscal year. One community experienced a 10 percent increase in enrolment and did not receive the additional funding until the following April, straining the community's education budget. Further, INAC officials in Saskatchewan verify the nominal roll by checking that each student is attending classes on a regular basis up to and including 28 September of each school year. The communities stated that funding based on regular attendance up to 28 September, which is subject to the interpretations of the visiting departmental officials, does not help the communities work with those students who do not attend school on a regular basis. These are the students who are also at risk of dropping out completely. These comments from First Nations are consistent with the findings of our audit of elementary and secondary education, reported in April 2000, which recommended that the Department improve the way the nominal roll is used.

1.37 First Nations told us that a number of reports are required on housing, including annual updates on housing conditions, the community's plans for new housing, and the number of houses built or renovated. However, the way in which INAC allocates funds is not based on need as shown in the required reports but rather on a funding formula which has been capped since the mid-1980s, according to the communities. These reports were not meaningful to the communities we visited.

1.38 Tribal council inspectors work with the communities to compile the housing information and submit it to INAC. In one tribal council we visited, the reporting requirement was characterized as physically impossible, that is, there were insufficient resources allocated to inspect all houses and renovations. In practice, they do not inspect individual houses with the exception of newly constructed ones (to ensure compliance with building codes). As a result, tribal council staff compiles the reports for INAC based on discussion with housing co-ordinators in the community, and some inspection of major renovations.

1.39 [illegible]

1.40 [illegible]

1.41 [illegible]

The National Child Benefit: A missed opportunity to report on results

Under the National Child Benefit (NCB) Program, First Nations adjust social assistance benefits and reinvest the funds saved in a wide range of program areas, including child day care, child nutrition, early child development, employment and training opportunities, and cultural teachings.

The NCB program is based on clear objectives intended to help prevent and reduce child poverty, promote an attachment to the workforce, and reduce program overlap and duplication. A framework for evaluation and accountability has been developed which specifies outcome indicators. In addition to a commitment to evaluate program effectiveness and impacts by 31 March 2003, the NCB is committed to continuing the monitoring process. The data sources for monitoring and evaluation include reports from First Nations.

The National Child Benefit Reinvestment Annual Report, the only report on NCB that Indian and Northern Affairs Canada requires from First Nations, does not reflect the outcome indicators. The regional office is supposed to implement the requirement for a reinvestment plan in each First Nation. This includes criteria that provide information respecting outcomes of the initiative. We did not see such guidance in the communities we visited. As a result, the NCB annual reports we observed provided descriptions, but did not provide meaningful information on results.

1.39 The continued receipt of federal funds is dependent on timely filing of the required audited financial statements. For example, INAC has set a deadline of 120 days after the end of the fiscal year for the receipt of audited financial statements. In one community we were told that not all First Nation-owned businesses use 31 March as the year-end, and this delays the reporting of consolidated financial statements to INAC. If the Department does not receive the audited consolidated financial statements by the 31 July deadline, discretionary funds may be withheld.

1.40 The National Child Benefit Program has required communities to report annually since 1998–99. We were told that this program and its reporting requirements were not adequately explained to communities. Some information was given about what could not be funded, but little about what was eligible for funding. Communities had to guess as to what was appropriate programming and reporting. One community we visited, not knowing what was required of them, did report extensively on their accomplishments. However, the other communities' annual reports mostly listed activities and expenditures (see case study, "The National Child Benefit: A missed opportunity to report on results").

1.41 Communities told us that they were concerned about the number and frequency of the reports required by Health Canada. They told us that the reports required under the contribution programs were repetitive, and could be combined. Another concern about these reports was that communities received no feedback from Health Canada officials in the Saskatchewan Region. Two of the communities told us "the reports go down a black hole." The prime interaction between communities and local Health Canada officials was to deal with community members' complaints about health service delivery.

The National Child Benefit: A missed opportunity to report on results

Under the National Child Benefit (NCB) Program, First Nations adjust social assistance benefits and reinvest the funds saved in a wide range of program areas, including child day care, child nutrition, early child development, employment and training opportunities, and cultural teachings.

The NCB program is based on clear objectives intended to help prevent and reduce child poverty, promote an attachment to the workforce, and reduce program overlap and duplication. A framework for evaluation and accountability has been developed, which specifies outcome indicators. In addition to a commitment to evaluate program effectiveness and impacts by 31 March 2003, the NCB is committed to continuing the monitoring process. The data sources for monitoring and evaluation include reports from First Nations.

The National Child Benefit Reinvestment Annual Report, the only report on NCB that Indian and Northern Affairs Canada requires from First Nations, does not reflect the outcome indicators. The regional office is supposed to implement the requirement for a reinvestment plan in each First Nation. This includes criteria that provide information respecting outcomes of the initiative. We did not see such guidance in the communities we visited. As a result, the NCB annual reports we observed provided descriptions, but did not provide meaningful information on results.

Source: INAC and First Nations communities

1.42 The four First Nations and two tribal councils we visited were very critical of the process used by Health Canada to bring in the new agreements. They said the process excluded them from any meaningful participation.

1.43 Staff members of an Indian Child and Family Services Program in one of the communities could not understand why their organization received funding for evaluations completed in years three and six of the program but not thereafter. They considered evaluations to be valuable management tools.

1.44 In one community, community leaders stated that it took them four years to develop their policy and procedures manual because they were so caught up in meeting their reporting obligations under their contribution agreements that they were unable to deal with the most strategic management issues.

1.45 Summarizing much of what we heard, one person said that the reporting requirements were a "crazy-quilt," patched together, with no one piece matching any other. A lack of federal co-ordination was cited as the main reason for this disconnect. For example, federal organizations required the communities to develop plans, in housing and community health programs, but the process was disjointed from the community viewpoint. Paragraphs 1.46 to 1.48 give examples of this lack of co-ordination.

1.46 The requirement for a five-year housing plan arose in connection with the 1996 change in the federal housing policy. Communities we visited put forward proposals to meet housing needs, and provide an annual update on housing conditions. Portfolio councillors for housing and health told us that they had undertaken surveys that demonstrated health risks from overcrowding in homes, including serious mould problems and inadequate sanitary facilities. They provided this information to INAC and Health Canada, but neither they nor the departments used it. In fact, we were told by local INAC officials that the housing plans were not used by them and they have no long-term impact on the communities' housing budgets.

1.47 The five-year housing plan and yearly updates that are provided to Indian and Northern Affairs Canada are not shared with the Canada Mortgage and Housing Corporation although the Corporation provides most of the government funding for the new houses built in the communities we visited. In addition, the Corporation relies on the Department for guidance on how to allocate the money by region. As the Corporation requires a ministerial loan guarantee, it does not allocate the funding until the Department is able to provide the guarantee. The Department is unable to provide this guarantee until 120 days after the end of the fiscal year, which allows departmental officials time to review the annual audited financial statements from the communities. As a result, the Corporation does not make its funding commitments until some time between August and October of each year. The communities advised us that this delay can result in winter construction which increases cost significantly, especially in remote communities.

1.48 Health boards and staff in communities told us that they expended considerable effort in developing the community health plans required by Health Canada. Under five-year transfer agreements, these health plans are required, and are updated when the agreements are renewed. Usually the health plans are based on surveys filled in by members of the community, and identify concerns that have the most priority. In one community, for example, the main priority is their youth. There are a number of federal organizations which do provide programs for youth. The staff and councillors responsible for youth were divided as to whether they should produce a community health plan or not. The reason was that the community could not implement the plan without federal co-ordination of various programs, which was not forthcoming.

Managing the reports is a challenge

1.49 An effective reporting system supports good management. We asked the sampled First Nations in Saskatchewan whether the federally required reports helped them to be successful. For the most part, they said no, for several reasons:

- the reports did not provide baseline data,
- there was no benchmarking of best practices that could be used by the First Nations when developing their programs and services, and
- there was little reporting on performance.

An exception with respect to reporting on performance is the Saskatchewan Indian Training Assessment Group Inc., which on behalf of the Federation of Saskatchewan Indian Nations holds the Aboriginal Human Resources Development Agreement (AHRDA) for Saskatchewan (see case study, "The Saskatchewan Indian Training Assessment Group Inc.: Meeting the management challenge").

Tribal councils are responding to the challenge

1.50 Because the system of federal reporting does not provide the performance information needed for good management, the two tribal councils we visited were developing performance measurement systems of their own. In one case, indicators will provide information on the performance of the education system. In the other, the tribal council has instituted a 20-year plan and is assessing progress through indicators and performance measurement.

1.51 The project to develop education indicators is in the initial stages. The planned indicators are intended to improve communication and support school system improvements by providing background information that can be used to interpret student results and demonstrate program quality. However, project funding has been secured from INAC only for the first two years, which are nearly completed. This has raised concerns about being able to secure a long-term commitment from INAC for this project.

The Saskatchewan Indian Training Assessment Group Inc.: Meeting the management challenge

The Federation of Saskatchewan Indian Nations, represented by the Saskatchewan Indian Training Assessment Group Inc. holds the Aboriginal Human Resources Development Agreement for First Nations in Saskatchewan. On behalf of the Group, the Saskatchewan Indian Institute of Technologies co-ordinates the responsibilities related to this contribution agreement with Human Resources Development Canada (HRDC) for all First Nations people in the province (on- and off-reserve) through management agreements with 24 local boards. These local boards operate quite independently and decide which employment training projects will be supported. The local boards report annually to the Group.

The program operates with tight controls. HRDC uses a population-based model to distribute funds and requires the Institute to submit an annual expenditure plan. A number of specific targets are negotiated annually including the number of individuals returning to work, the number successfully completing their programs, short-term Employment Insurance Account unpaid benefits, and the number of child care spaces that must be supported and occupied. Quarterly activity reports, financial data, and annual audited financial statements are also required. The Institute monitors local board activities semi-annually. It has an advanced database to manage client information, and send required reports electronically to HRDC headquarters. The reports are reviewed by HRDC regional officials, quality assurance is carried out, and results are reviewed in conjunction with departmental headquarters.

Source: Human Resources Development Canada and Saskatchewan Indian Training Assessment Group Inc.

1.52 The 20-year plan developed by the other tribal council is based on economic development goals, namely, to create jobs, and to achieve equality with the rest of Saskatchewan in education and income levels. The tribal council has established benchmarks from the beginning of the plan in the early 1990s and collected data to assess progress. The tribal council has demonstrated achievements, identified the areas most in need of attention, and focussed their efforts to move forward.

Federal organizations—Reporting process

1.53 We examined federal interactions with First Nations in setting requirements for reports, and processing, verifying, reviewing, and using the reports in our sample. We looked at ongoing non-financial and financial reporting within the annual cycle, as well as periodic reporting, such as needs assessments and evaluations. We posed some basic questions: Did federal organizations determine reporting requirements through discussions with First Nations? Was the reporting process as efficient as possible? What use did federal organizations make of the reports?

1.54 We also explored two major issues related to reporting, raised both by First Nations and federal officials. These issues were the need to improve performance information, and better co-ordinate federal organizations' reporting requirements.

Requirements need to be reviewed

1.55 We observed that programs have been added in recent years with little or no review of reporting requirements in existing programs. We noted a tendency toward "report creep", where the introduction of a new program invariably adds to reporting requirements. One example is the introduction of a new federal program that is closely related to an existing program. A case in

The Saskatchewan Indian Training Assessment Group Inc.: Meeting the management challenge

The Federation of Saskatchewan Indian Nations, represented by the Saskatchewan Indian Training Assessment Group Inc. holds the Aboriginal Human Resources Development Agreement for First Nations in Saskatchewan. On behalf of the Group, the Saskatchewan Indian Institute of Technologies co-ordinates the responsibilities related to this contribution agreement with Human Resources Development Canada (HRDC) for all First Nations people in the province (on- and off-reserve) through management agreements with 24 local boards. These local boards operate quite independently and decide which employment training projects will be supported. The local boards report annually to the Group.

The program operates with tight controls. HRDC uses a population-based model to distribute funds and requires the Institute to submit an annual expenditure plan. A number of specific targets are negotiated annually including the number of individuals returning to work, the number successfully completing their programs, short-term Employment Insurance Account unpaid benefits, and the number of child care spaces that must be supported and occupied. Quarterly activity reports, financial data, and annual audited financial statements are also required. The Institute monitors local board activities semi-annually. It has an advanced database to manage their information, and send required reports electronically to HRDC headquarters. The reports are reviewed by HRDC regional officials, quality assurance is carried out, and results are reviewed in conjunction with departmental headquarters.

1.52 [illegible]

1.53 [illegible]

1.54 [illegible]

Requirements need to be reviewed

1.55 [illegible]

[illegible]

1.56 [illegible]

1.57 [illegible]

1.58 [illegible]

Streamlining reporting in the Northern Inter-Tribal Health Authority

Through the Northern Inter-Tribal Health Authority, two First Nations and two tribal councils in Northern Saskatchewan jointly plan and now deliver higher-level coordination and professional support third-level services. A health status and surveillance unit monitors health needs, for example, infectious diseases and health status. Under the demonstration project, the Authority will undertake research over the next three years to examine several key issues:

- whether programs are sustainable or [illegible];
- how the programs should be governed;
- which groups are responsible for achieving certain results or outcomes; and
- what effect there would be on health conditions and status if the programs were delivered in a different way.

The demonstration project recognizes the importance of coordinating the information that the federal government needs with the information that is required by communities, and streamlining reporting requirements.

A key question raised by this project is the extent to which First Nations can renegotiate health programs and services. Instead of community health plans conforming to federal program initiatives, the planning process would be "bottom-up" or done at the community level, so that a First Nations health plan could require that some area of programming be completely eliminated to make way for new initiatives.

point is Health Canada's Home and Community Care Program, introduced in 1999, and INAC's longstanding Adult Care Program. The overlap between the programs is acknowledged by both departments.

1.56 We noted that external accounting firms are required to report to the chief and council the results of their audits of the financial statements, including a stated audit opinion. In one community, we noted different reporting styles in the various year-end financial statements. In addition, some requirements for reporting exceed what auditors normally are called upon to do. For example, Health Canada's reporting and auditing requirements for the agreements to transfer health services require auditors to certify matters such as the reporting of communicable diseases to provincial authorities, and the registration of nurses with their professional association. Saskatchewan regional officials told us that these additional requirements were not being followed or enforced.

1.57 A good practice in this area is a recent initiative undertaken by Health Canada that recognizes the importance of reviewing reporting requirements for the health services delivered by the Northern Inter-Tribal Health Authority (see case study, "Streamlining reporting in the Northern Inter-Tribal Health Authority").

1.58 The extent of non-financial reporting required by federal organizations varies considerably. Most of the reports required by INAC and Health Canada are non-financial. In contrast, reports required by CMHC and HRDC are largely financial in nature. HRDC also requires some non-financial information in quarterly and annual activity reports.

Streamlining reporting in the Northern Inter-Tribal Health Authority

Through the Northern Inter-Tribal Health Authority, two First Nations and two tribal councils in Northern Saskatchewan jointly planned and now deliver higher-level co-ordination and professional support (third-level services). A health status and surveillance unit monitors health risks (for example, infectious disease) and health status. Under the demonstration project, the Authority will undertake research over the next three years to examine several key issues:

- whether programs are sustainable or continued,
- how the programs should be governed,
- which groups are responsible for achieving certain results or outcomes, and
- what effect there would be on health conditions and status if the programs were delivered in a different way.

The demonstration project recognizes the importance of co-ordinating the information that the federal government needs with the information that is required by communities, and streamlining reporting requirements.

A key question raised by this project is the extent to which First Nations can re-negotiate health programs and services. Instead of community health plans conforming to federal program initiatives, the planning process would be "bottom-up," or done at the community level, so that a First Nations health plan could require that some area of programming be completely eliminated to make way for new initiatives.

Source: Health Canada

1.59 In Saskatchewan, both INAC and Health Canada track non-financial reports. Some are verified, usually the ones that are used to calculate funding levels, such as the list of buildings that is used for operations and maintenance funding. However, many are not. For example, INAC does not verify the reports on the enrolment of post-secondary students. Regional INAC officials also told us that non-financial information in social development programs, including the National Child Benefit Program and the Family Violence Program are not verified. The only verification conducted on the Child Care Program has been on capital purchases.

1.60 Health Canada officials that we met in the Saskatchewan Region indicated that in many cases, they do not rely on non-financial reports, such as annual reports, when dealing with First Nations. Notable exceptions to that practice include some targeted programs, such as the Tuberculosis Elimination Strategy. It centralizes control and reviews reports to monitor progress and measure how effective the program is. The lack of attention to many of the non-financial reports calls into question the need to provide them.

1.61 **Recommendation.** The federal government should consult with First Nations to review reporting requirements on a regular basis and to determine reporting needs when new programs are set up. Unnecessary or duplicative reporting requirements should be dropped.

Required reports are tracked, but most are submitted on hard copy

1.62 Since federal organizations require First Nations to submit a large number of reports within a specified time frame, they have developed various procedures to record the receipt and status of the reports. Although INAC and CMHC use automated systems to track reports, all of their reports are received in hard copy form in Saskatchewan. INAC officials advised us that electronic reporting was more advanced in other regions, notably the Atlantic region. These organizations log in reports and enter data in automated systems as the reports are received. In the case of HRDC, reporting occurs through activity reports, submitted in hard copy, and electronically through data uploads, so the Department tracks reports both manually and electronically. Health Canada Saskatchewan Region, in contrast, receives all its reports in hard copy and tracks them manually. However, Headquarters officials advised us that Health Canada's implementation of the automated Management of Contracts and Contributions System was more advanced in other regions.

1.63 Electronic reporting is clearly more efficient than processing reports in hard copy form, both for the First Nations and federal organizations. We also noted that computers and computer literacy are widespread among the staff in the communities and tribal councils we visited. Although we did not examine the actual capacity in this area we do feel that that it is sufficient, with proper assistance, to support a fully computerized reporting system. In addition, we saw some technical innovations in the First Nations and tribal councils we visited in Saskatchewan (see case study, "An innovative, technology-based approach to health data collection").

An innovative, technology-based approach to health data collection

One of the communities has developed a PalmPilot™-based database for their home and community care program. The system allows the nurse to record client identifiers (tombstone data), diagnosis, medication, allergies, care plan, incident reports and discharge information. This information is then electronically entered into the main database. The development and implementation of this system has resulted in a saving of five to seven hours of nursing time per month, which is now available for service delivery.

Health Canada is developing a separate but similar system to support the program nationally.

1.64 **Recommendation.** The federal organizations should [illegible] efficient procedures to submit and process reports [illegible] First Nations, and should work with First Nations communities to [illegible] electronically where it is practical to do so.

Financial reports are generally verified and reviewed

1.65 The federal organizations have adopted procedures to review and verify financial reports. These procedures differ for the review of audited financial statements as compared to other financial reports. INAC officers do "compliance and solvency reviews" in field and regional offices and identify issues in financial statements, which are independently audited and sent in by the communities. The other federal organizations follow similar procedures. Other financial reports include reports of expenditures that can be reimbursed, such as social assistance payments. These reports generally are checked for significant or unexplained variances. These procedures represented a reasonable effort on the part of the federal organizations.

1.66 The balance of financial reporting generally receives less attention. For example, Health Canada regional officials in Saskatchewan told us that other reports such as annual budgets and cash flow statements are often subject to limited review when received, to verify that services and staff are in place. This is also reasonable, given that budgets and cash flows [illegible] reflect the funding that is available.

Communication with First Nations is inadequate

1.67 Federal organizations that receive information from First Nations communities do not tell them how it is used, except for the review of audited financial statements. Nor do they communicate the results of any of their analysis of the information. INAC officials pointed out that the Department publishes reports and analysis based on the information it collects from First Nations and makes most of it available on the Internet. However, this analysis is normally presented in aggregate form, combining information from many communities on a regional or national basis, which can be difficult to relate to the information needs of individual communities. Timely, consolidated

An innovative, technology-based approach to health data collection

One of the communities has developed a PalmPilot™-based database for their home and community care program. The system allows the nurse to record client identifiers (tombstone data), diagnosis, medication, allergies, care plan, incident reports and discharge information. This information is then electronically entered into the main database. The development and implementation of this system has resulted in a saving of five to seven hours of nursing time per month, which is now available for service delivery.

Health Canada is developing a separate but similar system to support the program nationally.

Source: First Nation community

1.64 **Recommendation.** The federal government should use the most efficient procedures to submit and process reports required from First Nations, and should work with First Nations communities to file reports electronically where it is practical to do so.

Financial reports are generally verified and reviewed

1.65 The federal organizations have adopted procedures to review and verify financial reports. These procedures differ for the review of audited financial statements as compared to other financial reports. INAC carries out "compliance and solvency reviews" in its local and regional offices, to analyze and identify issues in financial statements which are independently audited and sent in by the communities. The other federal organizations follow similar procedures. Other financial reports include reporting for expenditures that can be reimbursed, such as social assistance payments. These reports generally are checked for significant or unexplained variances. These procedures represented a reasonable effort on the part of federal organizations.

1.66 The balance of financial reporting generally receives less attention. For example, Health Canada regional officials in Saskatchewan told us that reports such as initial budgets and cash flow statements are often subject to limited review when received, to verify that services and staff are in place. This is also reasonable, given that budgets and cash flows simply reflect the funding that is available.

Communication with First Nations is inadequate

1.67 Federal organizations that receive information from the communities do not tell them how it is used, except for the review of audited financial statements. Nor do they communicate the results, if any, of their analysis of the information. INAC officials pointed out that the Department publishes reports and analysis based on the information collected from First Nations and makes most of it available on the Internet. However, this analysis is normally presented in aggregate form, combining information from many communities on a regional or national basis, which can be difficult to relate to the information needs of individual communities. Timely, considered feedback is a necessary element of an effective reporting system, and for the most part, it seems to be missing.

Performance information is insufficient

1.68 In its First Nations National Reporting Guide, INAC states that it uses the reports required from First Nations to assess and report on statutory requirements, accountability, resource allocation, operational or administrative requirements, program planning, and policy analysis. Good performance information is essential to all of these functions. However, we found a number of obstacles in the way of its collection.

1.69 For example, data are collected on the school graduation rate, which is one output of the education system. However, other measures are required to assess final outcomes in terms of the quality of the education that graduates have received. First Nations schools do not have access to most of the services provided by school boards. Provincial departments of education that normally assess the performance of the education system do not do this in First Nations schools. As a result, First Nations do not have the means to obtain the required data. That is why some tribal councils have made a commitment to provide these services, and in one case, a tribal council is developing education indicators. In a remark attributed to an INAC official, the situation was summed up as follows: "We made a mistake. We transferred schools when we should have transferred an education system."

1.70 Another example relates to the reporting on social assistance. These reports provide detailed information on recipients for control purposes: to ensure that those receiving assistance are eligible and that the correct amounts have been paid. This type of information cannot be easily used to measure the performance of a program. In addition, the dependency rate, which is the proportion of community residents receiving social assistance, is probably not accurate. Officials from INAC told us that they do not know the actual number of residents in the communities. The Indian Registry System, the only source of this information updated annually, was not designed to collect information about the number of residents.

1.71 Reporting for a number of other social development programs, including Indian Child and Family Services, National Child Benefit and Adult Care, was also weak in terms of generating performance information. INAC officials told us that the Department did not have the tools or human resources to be results-focused (see case study, "The National Child Benefit: A missed opportunity to report on results"). This is a recent program for which reporting requirements were instituted in 1998-99; it is a situation where the government has missed an opportunity to measure performance.

1.72 Despite its good intentions, INAC needs to overcome these obstacles to the collection of adequate performance information. In particular, we noted that First Nations do not have access to support from boards of education and, for the limited performance information it collects, the Department lacks the tools and human resources needed to use it effectively.

Health Canada is developing performance measures

1.73 Health Canada is developing a First Nations and Inuit Health Program Compendium that identifies outcomes and performance indicators for each program. The Department's new agreements that many signed early in the fiscal year 2002–03, require First Nations to report on goals, objectives, and measures of outcomes. Since reports under the new agreements were not yet available at the time this study was completed, it was not clear how outcomes will be shown.

1.74 Health Canada also requires five-year evaluations of community health services. We noted that extensive evaluation studies have been undertaken, particularly in the tribal councils we visited. In one community the evaluation was combined with the health services plan, and identified priorities based on a membership survey. However, departmental officials in Saskatchewan told us that apart from a quick assessment when received, these evaluations were often not adequately reviewed because their local offices lacked the human resources to do so. Similar concerns were raised in our October 2000 follow-up audit chapter, Health Canada—First Nations Health.

Information for Parliament about First Nations needs to be improved

1.75 Federal organizations have a duty to report to Parliament both the financial and the non-financial results they have achieved with the authority and public funds entrusted to them. We examined the reports on plans and priorities and the departmental performance reports for INAC, Health Canada, and HRDC over the last three years. We did not examine CMHC, which, as a Crown corporation, reports to Parliament on a different basis.

1.76 Much of the information that federal organizations collect from First Nations reflects resource inputs (what was spent), activities (what was done), and outputs (what was produced), rather than outcome-level results (the impacts and effects of programs). We found that little of the information collected from First Nations was being used in the Estimates documents. The impacts and effects of the multi-billion dollar programs for First Nations were not adequately reported to Parliament. We noted an exception with respect to HRDC's reporting of performance against annual targets for the Saskatchewan Aboriginal Human Resources Development Agreement. Our detailed findings are shown in Appendix B.

1.77 Federal organizations do not need to report to Parliament in detail on First Nations' program activities. Doing so would overwhelm Parliament with information. More detailed information of this nature can be made available through other means, such as the Internet. What is needed is less information on activities, and more on results.

There is a need for better co-ordination

1.78 We found examples of overlap and duplication in federal organizations' reporting requirements.

1.79 One example of overlap is the requirement for externally audited financial statements. Up to five separate financial statements can be required from each community:

- one consolidated and one supplemental schedule for INAC,
- one for Health Canada programs under transfer agreements,
- one for Indian Child and Family Services, and
- one for CMHC.

1.80 Another example is reporting for children's programs. We identified nine federal programs directed toward First Nations children; we examined reporting for three of them, the National Child Benefit, Aboriginal Head Start, and Education. The clients served by these programs differ in some respects; for example, the programs do not all target the same age group. However, all the programs require activity reports and many of those reports identify the same children and parents, in small communities. Overlapping program objectives also cause confusion about which activities should be funded under which program, which can lead to unclear reporting on activities and expenditures.

1.81 The same can be said for Health Canada's Home and Community Care program and INAC's Adult Care Program. These are overlapping programs and both require reports that can be related to the same persons in a small community.

A way forward

1.82 Federal officials and First Nations have referred to the program structure as "stovepiped." The programs are narrowly defined, overlap, and can duplicate each other. We found that the reporting requirements mirror this program structure.

1.83 Federal organizations need to review and better co-ordinate their reporting requirements. This review needs to be undertaken in consultation with First Nations in order to ensure that First Nations' reporting and information needs are also being met. The number of reports and in particular the number of audited financial statements required from First Nations needs to be reduced.

1.84 Based on the results of this study and previous work of the Office, we suggest that the following criteria be considered as a means to test the reporting structure. An effective reporting system should

- be based on a clear understanding between First Nations and federal organizations;
- produce fair and reliable financial and non-financial information that is verifiable;
- be appropriately open and transparent to First Nations membership, the public and stakeholders, respecting personal and commercial confidential information;
- make full and efficient use of available technology;
- be organized to achieve results, and to collect information on performance;

- be useful to First Nations communities to manage their affairs, including financial management and managing for results; and
- assist federal organizations to assess performance, effectiveness and financial control, so that they can report to Parliament on public expenditures.

1.85 Ultimately, as the program structure evolves, an ideal reporting system, as part of managing for results, would include performance measurement (both financial and non-financial); with reports on community outcomes feeding into reports on national outcomes. This approach would lead to

- adequate reporting on performance achieved,
- serious review of the information reported, and
- consequences from the reporting, in the sense of changes related to the review.

1.86 In our view, the program structure is a significant obstacle to the much-needed reform of First Nations reporting requirements. We were told that INAC, and Health Canada in the Saskatchewan Region, do not have the human resources needed to review and consider reports from First Nations effectively. INAC and Health Canada also told us that they are renewing their program authorities. This is an opportune time to streamline programs and better allocate program responsibilities.

1.87 **Recommendation.** The federal government should undertake a review of program authorities to streamline the programs and better allocate program responsibilities among departments and other federal organizations.

Conclusion

1.88 This study has assessed the reporting that selected First Nations in Saskatchewan are required to provide to the major federal organizations. We found that a large number of reports are required, yet few meet the needs of the First Nations or of the federal government.

1.89 The reporting system does not do enough to help First Nations or federal organizations meet management challenges, but it does provide employment to many community members. The resources devoted to the current reporting system could be put to better use, collecting adequate information on performance, and managing the programs.

1.90 While reporting requirements need to be streamlined, the underlying program structures are an obstacle to a more effective system. Instead of information on narrowly-defined program activities, reporting needs to provide meaningful information to First Nations and to the federal government. Fundamental change is required, and we suggest criteria to guide future assessment of the reporting system.

Government's response. The federal government is committed to improving the current reporting structure; in this regard, the criteria offered in this study will be useful. As noted in the report, this is not a complete review of national reporting and caution must be exercised in generalizing results based on only four First Nations and two tribal councils in one region; however, the desire to reduce the "reporting burden" on First Nations is accepted. Similarly there is a need to address this issue across departments and strive for a more results-based system in support of a government-to-government relationship. Such a system needs to be responsive to the requirements of First Nations and they clearly should be consulted. At the same time, the federal government remains committed to reporting to Canadians on the use of public funds and therefore there must be a balance achieved between the First Nations and the federal government's reporting requirements.

The federal government agrees that reporting should be transparent, administratively efficient, meaningful (performance based), rationalized across the federal government and related to sound program management. Consistent with these principles and in response to the specific recommendations of this study, the federal government is committed to reviewing reporting requirements both individually as departments and collectively, as a horizontal (across government) initiative, taking into consideration that CMHC is a Crown Corporation bound by separate policy and legislation that impacts on reporting requirements, and the nature, and financing of its programs. This work has already started through program authority reviews which are underway in a number of departments. Additionally, existing program areas are being examined to determine where "single window" reporting could serve the federal government at large. This interdepartmental initiative is being supported by an ADM level Steering Committee which has been established to direct horizontal work to foster a principle-based accountability framework for all federal Aboriginal programming, leading to improved program effectiveness through measurable results. Electronic data exchange continues to be pursued by the federal government, consistent with the Government on Line (GOL) initiative. For example, systems have already been implemented to facilitate electronic monitoring and management of reports in a number of departments. The federal government will build on these successes and promote electronic data exchange as a way of doing business with First Nations.

Reporting, both financial and non-financial, is an essential element of the accountability relationship between the federal government and First Nations. The federal government needs to attest to effective spending of funds appropriated by Parliament for the use of First Nations; First Nations leaders need to account to their membership for the manner in which they conduct their affairs on behalf of their communities. The ideal is to strive for a system of information exchange that serves the interests of both parties. In this regard, a First Nations led initiative to develop a First Nations Statistical Institute (FNSI) offers some potential to address the shortcomings of the current data quality and data development issues. The FNSI is designed to play an important role in the interpretation and analysis of data being collected on social, economic, and fiscal conditions of First Nations peoples and institutions, helping to address the information needs of First Nations. This work will also support First Nations in community planning, program evaluation and assist program service delivery.

About the Study

Objectives

The objectives of the study were the following:

- to assess federal reporting and audit requirements for selected First Nations communities, including the nature of the requirements and how they are met;
- to examine how these reports and audits are used, both by the federal government and the First Nations communities; and
- to set out criteria for an effective reporting and external audit system.

Scope and approach

To carry out our study, we secured the participation of four First Nations communities and two tribal councils in Saskatchewan. We examined the reporting requirements set by the four federal organizations with the largest expenditures in support of Aboriginal peoples, and within these organizations selected several major programs as the focus of our study.

We developed a number of lines of inquiry for the study, including the following:

- the authority or source for the requirements, and the link with federal programs,
- the way reports and external audits are prepared, and related capacity issues,
- the communication of key information to First Nations communities,
- the review and administrative processing of reports and external audits by federal organizations,
- the use of reports and external audits within federal organizations and their reporting to Parliament,
- the communication of data analysis from reports and external audits to First Nations communities,
- the use of reports and external audits by First Nations communities, and
- the extent to which the reports and external audits meet the needs of First Nations communities.

Study team

Assistant Auditor General: Maria Barrados
Principal: Jerome Berthelette
Director: Tom Wileman

Martha Fortier
Ernie Glaude
Patricia Sims
Frances Smith

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll free).

Appendix A First Nations required reporting to selected federal organizations

Name of report and frequency	Report description
INAC requirements / non-financial reports	
Non-registered on-reserve population data	
Non-Registered On-Reserve Population Certificate Yearly on 15 February	This certificate should accompany the corrected non-registered on-reserve population data and should include band information, and the total numbers of non-registered residents on-reserve.
Non-Registered On-Reserve Population Collection Form Yearly on 15 February	This form is a supplement to the computerized listing sent out to bands. It lists the following: • Collector's personal information and collection date. • List of all individuals who are not registered under the *Indian Act*, name, birth date, and gender. • Whether the individual resides on reserve and if so, which one. • Any alias the individual may use.
Indian registration	
Indian Registry Data Entry Monthly	Information requirements include up-to-date information on the following: • Births. • Age of majority. • Marriages. • Divorces and any transfer of custody of children. • Confirmed deaths. • Any other additions or amendments to existing Indian Registry data.
Indian Registry Data Entry Miscellaneous Amendments Monthly	Changes to entries on the Indian Registry, such as name change or corrections, are recorded on this form.
Education	
Elementary and secondary education	
Nominal Roll School Summary Report Yearly on 15 October	In this report all First Nations are requested to provide a list of the total number of students registered in schools in each grade level at the start of the year.
Nominal Roll Student Census 15 days after a census	This form includes the following: • Student identification, including the relevant registration numbers, full name of each student, grade, and school information. • Date of birth, gender, and status code. • Details of residence, band, reserve of residence, accommodation, district, and band of financial responsibility. • Details of transportation arrangements, special education needs, and extent of Indian language instruction.

Name of report and frequency	Report description
INAC requirements / non-financial reports (continued)	
Certification of Teachers and Curriculum Yearly on 15 October	This form is to be filled out by school principals as part of the nominal roll submission at the start of each school year. It should include: • School name, and school year. • Names of the teachers and their teaching certificate number. • Principal's signature certifying the accuracy of the teaching staff and certificates as well as certification of the curriculum.
Approved School Transportation Certificate Yearly on 15 October	This confirms that all school vehicles have been certified in accordance with the *Saskatchewan Highway Act* and Regulations.
School Evaluation Report Every 5 years	This report for elementary and secondary schools is filed by band councils and does the following: • Reviews the school curriculum. • Assesses the instructional quality and standards. • Determines whether the community and school's objectives have been achieved.
Post-secondary education	
Register of Post Secondary Students Yearly on 1 December	This report is based on November 1 census information for the current school year and includes information such as the following: • Indian Registry number, date of birth, gender, and full name of the student receiving post-secondary funding. • The name and code of the post-secondary institution attended by each student, the area of study, the length of the program, the current year of study, and the qualification being sought. • Whether or not a student is part-time or full-time.
Report on Post-Secondary Graduates Yearly on 1 December	This annual report includes detailed student information on all graduates and the total number who received post-secondary education funding in the previous year.
Administering Organization Summary Data Report Yearly on 1 December	This report includes information on the following: • Students funded in previous fiscal year. • Students funded in current year (includes those who have dropped out prior to census date). • Graduate Summary.

Name of report and frequency	Report description
INAC requirements / non-financial reports (continued)	
Social development	
Social assistance	
Social Assistance Monthly Report Monthly on the 10th day for Comprehensive Funding Arrangement (CFA)	This report includes the following: • The number of families, number of people in each family, and the number of single persons on social assistance. • Various reasons why individuals and their dependents are in receipt of social assistance (that is, unemployable—single parents, disabled, or not fully employable; and employable—singles, families, single parents, or Work Opportunity Program transfers). • The amount of money each family receives in basic assistance. • The amount spent on fuel costs, utilities and rent, as well as the total number of dwellings for which these services are provided through social assistance funds. • Details on work opportunity projects, including the number of projects, the number of people employed through projects, and the total amount of money transferred.
Social Assistance Annual Report 30 May for fiscal year ending 31 March for Financial Transfer Arrangement (FTA)	This report includes the following: • Number of eligible families, persons in the family, and singles receiving social assistance by reason (for example, employable and unemployable—single parent, disabled, or other). • Number of person-months of training and/or employment provided under social assistance transfer for recipients. • Total annual amount of funds transferred from Basic Needs to social assistance transfer initiatives. • Annual total number of social assistance work/training projects approved. • Annual average monthly number of children out of parental home.
National child benefit (NCB)	
NCB Reinvestment Annual Report 30 May for programs funded by Comprehensive Funding Arrangement and Financial Transfer Arrangement	This report includes the following: • The name of the First Nation or agency administering the NCB program and year of the report. • Annual amount of funds available for reinvestment programs. • Individual programs implemented, whether new or continuing, and funds expended for each program. • Objectives for each program as well as a description of the results or accomplishments of each program compared with the original objectives. • The number of families and children under the age of 18 who benefited from the program.

Name of report and frequency	Report description
INAC requirements / non-financial reports (continued)	
Child and family services (CFS)	
Child Care Notification Form Monthly on the 10th day for services funded by the Comprehensive Funding Arrangement	This form is completed when a child is removed from its home and placed under child protection in alternative care facilities. It includes the following: • Child information (name, gender, birth date, address, health insurance number). • Where child was apprehended from, reason that a Notification is being completed. • Type of care being provided, type of action taken under the *Child and Family Services* (CFS) *Act*, date action was taken. • Information on both parents indicating who is the care-giving parent with Indian Status and who is the custodial parent. • Information on person providing care if the birth parent is no longer doing so, and entity that is financially responsible for the child (for example, INAC, Provincial Social Services, or provincial Justice Department).
Special Needs Greater Than $2,000 Report Monthly on the 10th day for CFA fund	Special Needs Greater Than $2,000 requests need approval annually by INAC and state the special need requirement for each child including estimated yearly cost over $2,000.
CFS Operational Report Twice yearly on Oct 15 and April 15	This report for INAC operations funding is to reflect services to residents who are normally resident on the agencies' member reserves and includes the following: • Information on Prevention Services (list of specific services provided; number of families and children served by each; number of local CFS committees active; number of elder committees; number of Public Information and Education workshops) • Information on Protection Services (list of specific services provided; numbers of families served with/without placement; number of trained/approved foster care homes and parent aides contracts; number of children placed in off-reserve resources; number of children having status under the CFS Act; and number of adoption homes)
CFS Evaluation In the third and sixth year of operation	INAC provides funding for each new CFS organization to complete an internal review of its operation in the third and sixth year, in order to identify weaknesses and strengths and to plan any desired improvements to the quality of its services. The report does not have to be released to the Department, but INAC states "any new CFS needs to review its progress." (Program Directive 20-1) Reports after the sixth year are the responsibility of the CFS.
Adult Care	
Institutional Adult Care Placement Federal Funding Criteria form Yearly on 31 March and after each new placement after 31 March	This form is to be filled out when an adult is placed outside of his/her normal family residence and is submitted for each new placement that occurs after March 31. The form is also to be completed annually on March 31 as an evaluation to meet federal funding criteria. It includes the following: • Client personal information. • Date on which the adult entered and left care. • Next of kin/public trustee responsible for client along with his/her personal information. • Assessed level of care needs, client resources available to meet care needs.

Name of report and frequency	Report description
INAC requirements / non-financial reports (continued)	
Home Care Services Report Monthly on the 30th day for Comprehensive Funding Arrangement and yearly on May 30 for Financial Transfer Arrangement	It includes information such as the following: • Client personal information, and age group. • Number of hours spent on homemaking/management jobs, as funded by INAC. • Number of hours spent assisting a client with daily living activities, as funded by INAC. • Other work hours, such as number of hours spent on minor out/indoor tasks, installing safety devices, and assessment hours.
Indian government support (band support funding)	
Band Support Funding Application for Grant Yearly on June 1	This form provides up-to-date data so as to increase support for FN administration. It includes information such as: • Band name, number, district number, region number, and tribal council affiliation. • Type of funding agreement (for example, Financial Transfer Arrangement (FTA) or Comprehensive Funding Arrangement (CFA). • Population counts as of 31 March (including registered and non-registered, and residents and non-residents). • Profile of departmental contribution (including Federal/Provincial agreements, income support, and major capital and basic services) in total dollar value to INAC for each program/project, number of units anticipated for the year for each program/project, and the number of band staff employed for each program/project for basic services only.
Capital Projects (band based)	
New Housing Capital Workplan As agreed upon	To acquire approval, this report is to be completed prior to commencement of a project. It provides details required for the First Nation tribal council to update the Capital Management Database for New Housing. Some of the information to be included is the following: • Information about construction area and approval of site inspection and water and sewer servicing. • If unit is being constructed under Canada Mortgage and Housing Corporation (CMHC) housing program. • Type of heating, sewage disposal, and source from which water is supplied. • Cost breakdown and funding sources.
Housing and infrastructure—Reports are required from tribal councils, unaffiliated First Nations and First Nations funded by Financial Transfer Arrangements.	
Housing Conditions Annual Report Yearly on 31 January	Information reported includes the following: • First Nation general information. • Number of houses requiring major renovations because they failed to meet National Building Code standards. • Number of houses requiring replacement or considered to be adequate. • Number of houses requiring minor renovations to maintain their useful life. • Total number of houses in the community. • Number of houses that lack basic indoor plumbing facilities.

Name of report and frequency	**Report description**
INAC requirements / non-financial reports (continued)	
Water Delivery Systems Annual Report Yearly on 31 January	This report should include the following: • Number of housing units with each of the following water delivery systems: piped, wells, trucks, no service, or other. • Number of housing units falling into each category of type of plumbing. • Information on the quality of domestic water supply.
Sewage Systems Annual Report Yearly on 31 January	This report includes the following: • Number of housing units with each type of sewage system (for example, piped, community or individual septic field/tank, septic truck, no service, or other). • Assessment of the health and hygiene standards of the disposal system (whether it meets provincial/territorial standards or poses an environmental threat).
New Housing Policy Annual Report Yearly on 30 June	For First Nations funded under the new on-reserve Housing Policy or the Housing Demonstration Initiative as well as FTA funded First Nations, a submission of an updated community-based housing plan is required. This report includes information on the following: • Community housing conditions; maintenance and insurance programs. • Actual and planned construction or renovation activities. • Link with community infrastructure, particularly servicing of existing and new housing lots, and training. • Employment and business development plans. • An updated resource plan for the next five years.
Housing Totals Annual Report Yearly on 31 January	This report includes information on the numbers of new houses built, houses used for special purposes, houses destroyed by natural disaster or poor conditions, and houses that had renovations completed.
Community Services Annual Report Yearly on 31 January	This report is to be completed if there were changes to the previous year's report, and provides information such as the following: • The type of electrification provided, for example, no service, grid, full/restricted service generated by diesel or full/restricted services generated by a source other than diesel. • Adequate or inadequate community road access. • Assessment of the solid waste disposal for the community according to provincial/territorial practice, for example, adequate, inadequate, poses health or environmental threat, or no service at all. • Type of fire protection service the community has, for example, verified by a site survey, non-verified, or no service.

Name of report and frequency	Report description
	INAC requirements / non-financial reports (continued)
Capital assets	
Capital Assets Inventory System Update Yearly on 30 September	The computerized system is updated every year on and requires detailed information on changes in capital assets from First Nations, including: • New capital on assets (excluding housing). • Capital assets that were destroyed or disposed of during the fiscal year. • Capital assets that have been modified or improved in some way. • For each asset the update should include cost, description of use and purpose, category (for example, a building, a utility, grounds, transportation, or vehicles), and details on type of addition, deletion, or modification.
Maintenance Management Plan Annual Report Yearly	This report should include the following: • Capital Assets Inventory System updated inventory list. • Updated performance standards for each asset (for example, activities, frequencies, schedules, quality standards). • Work assigned and inspections carried out as per schedule. • Asset operation and maintenance records. • Asset Condition Reporting System.
Asset Condition Reporting System Annual Report Yearly	Updates contain information on the condition of capital assets.
Economic development (ED)	
Economic Development Report Yearly on 31 May	A form linking financial information reported to statistical results must be completed along with the report. The report should include information such as the following: • List of all revenues received and expenditures/investments incurred for economic development activities. • Total number of people placed in training programs and jobs obtained as a result of training. • Total number of training days. • Indirect funds obtained through the Community Economic Development Organization (CEDO) for training, support of business expansions, and new business startups, support of resource management activities, and other related activities. • Number of new or existing businesses that received technical support. • Number of businesses started or expanded and the number of jobs created. • Number of resource projects that received technical support. • Number of jobs created as a result of financial or technical support for resource management. • Number of other economic development activities the recipient is involved in and the number of jobs created as a result.

Name of report and frequency	Report description
INAC requirements / non-financial reports (continued)	
Opportunity Fund / Resource Acquisition Initiative / Major Business Projects Program Project Status Report 12 months after receiving Opportunity Fund or Resource Acquisition Initiative funding, or 1, 3, and 5 years after receiving Major Business Project Program funding.	Included information would include the following: • Organization (CEDO) and project specific information. • Brief description of the project including sector in which the business is involved, products / service provided. • Ownership structure of the business entity (i.e. percent of Aboriginal/Non-Aboriginal ownership). • Location of business (on or off reserve). • Amount of funding received from INAC, the program through which it was accessed, and the date that the CEDO received the contribution for the project. • Dollar amounts for the projected and actual sources of funding. • Dollar amounts for the projected and actual uses of funding. • Record of the financial statements for the first year of operations. Recipients of Major Business Projects Program funding are required to report to INAC 1, 3, and 5 years after receipt of the funding. • If the project is operational, the benefits to date should be described including skill enhancement among employees, wealth creation, reduced social dependency by job creation, access to new markets, economic spin-offs, and significant effects the project had on the community. • Number of jobs created, number maintained (full or part-time). • Challenges which hindered the operation of the business, actions taken to mitigate them, and activities undertaken to operationalize the business.
Resource Partnerships Program Project (RPP) Status Report 12 months after funding and after 3 and 5 years, if applicable	Information reported includes the following: • Applicant specific information including information on the CEDO that received the funds and the proponent, date, and amount which the applicant received from the CEDO. • Description of resource development and how the resource will be used along with the total cost of the project and an expected time frame. • Description of the activities for which the funding has been approved and the expected outcomes and benefits. • Identification of anticipated/confirmed partners and description of their commitment (for example, cash or non-financial contributions). • Status of the RPP project (for example, whether it is completed, or in-progress) and direct and indirect objectives that have been achieved. • Description of the projected impacts and benefits of the project including Stage 1: Strategic Planning (achievements in terms of consensus building, priority setting, partnership opportunities) and Stage 2: Joint Working Agreement (JWA) Negotiation Activities (status of completed JWA, activities completed towards the formation of a JWA). • Report on the projected longer-term benefits of the RPP funding including number and duration of full/part time jobs; dollar value of contracts, sub contracts, and community revenue to be generated; number of business start-ups, joint ventures, trained people; and impacts on the community.

Name of report and frequency	Report description
INAC requirements / non-financial reports (continued)	
Regional Partnerships Fund (RPF) Project Status Report 90 days after the 1st, 3rd and 5th fiscal year end following full disbursement of the contribution	Information reported includes the following: • General details of project applicant and project funded, including date and amount of disbursed funds. • Description of the infrastructure that the project/initiative proposal is related to, including total cost and duration. • Activities for which the funding has been approved including expected outcomes and benefits. • Brief description of partners including level of commitment (percent) and amount (if financial) or explanation of non-financial commitment. • Conditions imposed on project prior to funding. • Information on status of initiative (completed or in progress); objectives (achieved or not achieved); conditions; JWA/Partnership Agreement, if applicable; and funding from sources other than INAC RPF. • Information on the impacts/benefits of the project to the region, community or communities, people, environment, including specific numbers impacted.

Name of report and frequency	Report description
	INAC requirements / financial reports
Elementary and secondary education	
School board invoices to band councils 31 January, 30 April, and 31 July	Copies of provincial or territorial school board invoices to band councils are due for First Nations students attending off-reserve schools. As well, a list of these students is to be provided to verify how INAC funds are being spent and to request additional funds if necessary.
Child and Family Services	
Indian Child and Family Services Child Specific Invoice Summary 10th day of the month for CFA	This report is submitted to INAC by the agency providing the service to request reimbursement. It includes a summary for the month containing the following: • Child information (such as name, member number, and date of birth). • Date of admission into care, type of care, and most recent placement date. • Start and end pay date, basic maintenance total, skill fee or fee for service, special needs description, and total, and total amount invoiced.
Adult care	
Institutional Residential Adult Care Placement Invoices 30th day of the month	These invoices are due each month for the month prior and summarize all clients' costs to the institution for funding.
Capital Projects (Band Based)	
One-Year Band-Based Capital Plan Yearly as agreed upon	The plan and detail sheets outline the plans for capital expenditures for the upcoming fiscal year and includes the following: • Name of the First Nation and code number. • Current band based capital allocation including special initiatives. • All individual expenditures, total planned expenditures, calculated housing subsidy, infrastructure, and renovation unit costs.
Capital Projects Summary As agreed upon	The summary lists the capital projects planned to be undertaken for the year and itemizes the funding source and total for each project.
Renovations Capital Workplan As agreed upon	This provides details of cost breakdown and source of funds for any renovations, including the following: • Itemized work to be completed including cost of material and labour. • Status of sewer service approval by Health Canada. • Itemized funding sources for the project. • Inspection agency and officer.
Other Capital Workplan As agreed upon	This workplan provides details on the construction or renovation of other capital facilities to acquire approval. It includes the same information as the Renovations Workplan.
Certificate of Completion for Minor Capital Projects As agreed upon	The certificate certifies that all work on the project is complete, including payments for goods and services.

Name of report and frequency	Report description
	INAC requirements / financial reports (continued)
Consolidated reporting	
Consolidated Financial Statements Yearly	The First Nations are required to submit these in accordance with generally accepted accounting principles which shall be audited in accordance with generally accepted auditing standards. They shall • be dated 31 March; • consist of a Statement of Financial Position, a Statement of Operations, a Statement of Cash Requirements, a Statement of Expenditure Authorities Used and notes and schedules (salaries, honoraria, and travel); • be accompanied by a Statement of Management Responsibility and an Auditor's Report; and • be based on recommendations by the Canadian Institute of Chartered Accountants as outlined in the Public Sector Accounting Handbook.
Schedule of Revenues and Expenditures Yearly	INAC requires the First Nations to prepare a separate schedule for each individual program and/or service specified in the funding agreement as well as a separate schedule for each program and/or service funded through a contribution authority. At a minimum, the revenues and expenditures schedules must • account for expenditures by object and revenues by source; • present cumulative surpluses or deficits; and • detail opening and closing balances of deferred revenue.

Name of report and frequency	Report description
Health Canada requirements / non-financial reports	
Aboriginal Diabetes Initiative	
Annual Program Activity Report Yearly	This is expected to include all end products and deliverables, and copies of any resource materials generated and developed as a result of the project. It must include information such as the following: • An update on the status of the project. • Activities undertaken to date. • Number of clients who were provided services. • Details on any partnerships developed. • Link to other programs. • Samples of all end products and deliverables. • Samples of any resource materials generated or developed as a result of the project.
Workplan/Activity Report Workplan yearly Activity Report due October, January, June	Reports on tasks, success criteria, and progress to date.
Aboriginal Head Start on Reserve	
Community Needs Assessment Submitted with proposal	The assessment must include the following: • A detailed description of the children, including ages and gender, and their families who will be a part of the project. • Description of the needs of these children and their families. • Description of existing programs and services in the community.
Program Activity Report Bi-yearly 15 October and 15 January	Reports for these should include the following: • Number of children involved in the project, by age and gender. • Number of children with special needs by age, gender, and type of special need. • Number of parents involved in the project. • Number of staff. • Staff-child ratio. • Number of children on waiting lists. • Number of visits made by public or community health nurses or representatives, National Native Alcohol and Drug Abuse Program representatives, mental health workers, youth workers, Elders, diabetes workers, nutritionists, or other representatives. • Number of visits by dental staff.

Name of report and frequency	Report description
Health Canada requirements / non-financial reports (continued)	
Annual Program Activity Report Yearly	This report includes the status of the project and the activities undertaken to date, such as the following: • Composition of parental advisory committee. • Extent to which culture and language, education, health promotion, nutrition, social support programs, and parental and family involvement are addressed. • Partnerships developed with other programs and services. • Curriculum developed for the program (entire program initially and any modifications). • Evidence of maintenance of health and safety standards. • Copy of the standards being used and the plan for monitoring and recording. • Suggestions or recommendations for future projects or continuation of the project.
First Nations and Inuit Home and Community Care Program **Phase 1: Program needs assessment and service delivery plan development (not observed in the sampled communities)**	
Phase 2: Service delivery plan implementation	
Annual Report 120 days after the year-end	A detailed report on the project should include the following: • Evidence of adequate liability coverage. • Copy of the data collected during the implementation phase on the status of the program, the essential service elements, and the supportive services elements. • Evidence of purchase of training for the personnel, in accordance with the courses approved through the Regional Training Plan, and copy of evidence of certification of the personnel. • Evidence of purchase of equipment in accordance with the requested approved through the Regional Capital Plan.
Phase 3: Service delivery – Communities that have moved to this phase meet the requirements for this phase only	
Program Activity Report	Due 15 July, 15 October, and 15 January, as per the required program data elements contained in the service delivery reporting template.
Annual Report 120 days after the year-end	A detailed report on the project should include the following: • Evidence of adequate liability coverage. • Evidence of certified trained personnel. • Evidence of maintenance of health and safety standards and adherence to legislation. • Service utilization and program data as per the service delivery reporting template.
Tuberculosis Elimination Strategy	
Program Activity Report Monthly 15 May to 15 March	This report must include: • A description on all tuberculosis (TB) cases diagnosed, by completion of a federal case report form for TB. • Any suspected outbreak situation in which two or more TB cases have been diagnosed.
Statistical form Monthly 15 May to 15 March	Report includes information on the Directly Observed Medication Program and other program activities such as the number of tests conducted and client visits.

Name of report and frequency	Report description
	Health Canada requirements / non-financial reports (continued)
Transfer programs	
Evaluation Every five years	An evaluation of the community's health programs and services is required during the fourth year of every five-year period. It is designed to assess the effectiveness of community health programs and objectives, and to determine any changes in the health status of community members.
Community Health Plan From day one of the agreement and updated prior to signing a new agreement	A Community Health Plan (CHP) is the first step in planning what health programs communities want to provide for their members. When developing the CHP, communities have to begin thinking about evaluation. For example, the CHP should specify the following four items that tie in with evaluation: • The programs and activities that communities plan to conduct. • The goals and objectives for each program on activity. • The indicators that communities use in their evaluations to measure how well programs meet their objectives. • The day-to-day records and other evaluation information that staff collect when programs are running.
Annual Report Yearly	The chief and council or their designated representatives are responsible to produce and make available to Health Canada and to all members an annual report to community members which • is based on the goals and objectives of the Community Health Plan. • summarizes programs and financial information. • provides data on services, operations and results. • explains any deviations from the Community Health Plan. • is available to community members within 120 days following fiscal year-end. • includes reports on mandatory programs: (1) Communicable Disease Control: • Annual summary. • Immunization Level (by age, gender, antigen). • Tracing people who have come into contact with the sick person and follow-up of treatment. (2) Environmental Health: • Annual summary, and notification within 24 hours of environmental hazards. • Total number and percentage of facilities meeting provincial/federal environmental standards for food services, water supply, sewage and garbage, pollution, and hazardous substances. (3) Treatment Services: • Annual summary. • Total number of patients seen in diagnostic categories as specified in the Community Health Plan.

Name of report and frequency	Report description
Health Canada requirements / financial reports	
Aboriginal Diabetes Initiative	
Financial Report Yearly	The recipients of Aboriginal Diabetes Initiative funds must provide a financial report including a budget cash flow, and financial reporting due dates, detailing amounts (budgeted and actual) spent on the following: • Care and treatment services. • Prevention and promotion activities. • Lifestyle support services.
Financial Progress Reports As listed	Report on actual expenditures for 1 April to 31 August is due 15 October, for 1 April to 30 November is due 15 January, and an Annual Audit for the entire agreement for the period 1 April to 31 March is due 120 days after year-end.
Aboriginal Head Start (AHS) On-Reserve	
Financial Report Yearly	The financial report must include a budget, cash flow and financial reporting due dates detailing amounts budgeted, and actual amounts spent on the following: • Needs assessment. • Capital. • Sources of other funding and in-kind contribution with amounts actually spent on the Aboriginal Head Start On-Reserve project each year.
First Nations and Inuit Home and Community Care (HCC) Phases 1, 2, and 3	
Financial Report Yearly	The Financial Report should include a budget, cash flow forecast, and a report on program expenditures detailing amounts spent on program needs assessment and service delivery plan development, training, capital, and management and support.
Financial Progress Reports	Reports on the actual expenditures are due 15 October, 15 January, and 30 June.
Tuberculosis Elimination Strategy (TES)	
Year-end Financial Report Due 30 June	The report details amounts spent. It is combined with the Final Program Report that is a detailed report on the status of the Tuberculosis Elimination Strategy project.
Transfer programs	
Comprehensive Auditor's Report Yearly within 120 days following fiscal year-end	The First Nations are required to submit this report which is to be produced by an independent accredited auditor in accordance with generally accepted auditing standards. It includes: (1) Report on health expenditures (Schedule A). (2) Report on moveable capital assets reserve (MCAR) (Schedule B). (3) A certification, based on attest audits that: • financial and other reports required under the Transfer Agreement were completed and are accurate, • resources expended were used for health related programs/activities, • the MCAR has been used for the purpose stated in the agreement, • personnel such as nurses and those providing services are certified, • immunization reports and communicable diseases cases have been sent to the region, • the First Nations has a Community Health Plan maintained to reflect programs/services available in the community, and • a medical health officer has been hired when services are not provided by the First Nations and Inuit Health Branch of Health Canada. (4) An opinion on the band's compliance with the terms and conditions of the Agreement.

Name of report and frequency	**Report description**
	HRDC requirements / non-financial reports
AHRDA Program	
Written agreement between an AHRDA holder and a third party for funding At time of agreement	When funds from HRDC are provided to a third party by the organization (the AHRDA holder) to support projects or activities, the organization should ensure there is a written agreement between it and the third party setting out obligations, and terms and conditions of the funding. It should include the following: • Identification of the third party organization, and the purpose of the financial assistance. • Effective date, date of signing, and duration of agreement. • Financial and/or non-financial conditions attached to the assistance and consequences of failing to adhere to the conditions. • Allowable costs of the project or activity; the maximum amount payable. • Conditions to be met before payment is made, and schedule and basis of payment.
Quarterly Progress Reports Quarterly	The organization must provide HRDC with these reports concerning the progress of the programs and containing information on each participant in its programs in order to evaluate and assess the effectiveness of the assistance, the reports must include the following: • Participant's personal information. • Aboriginal status, marital status, number of dependants. • Disability status, assessment regarding employability. • Name and length of program. • Cost and income support, completion, and follow-up information.
Monthly/Quarterly Progress/Activity Reports Monthly/quarterly	Reports are to be provided including the above information as well as results targets such as the following: • Number of EI clients or unemployed individuals who return to employment, completing labour market interventions. • Savings to the EI account. • Savings to the Income Support programs. • Number of youth completing youth program interventions. • Number of youth who obtain employment or return to school. • Number of disabled individuals who return to employment or complete labour market interventions.
Annual Report Following fiscal year-end	Reports on AHRDA's activities must include the following: • Description of the organizational structure of the AHRDA holder. • Progress on capacity building that was achieved during the year. • Programs that were delivered during the year. • Achievements and results of programs that were run during the year. • Lessons learned and best practices identified during the year. • The annual audit report.

Name of report and frequency	Report description
	HRDC requirements / financial
AHRDA Program	
Expenditure Plan Yearly not less than 30 days prior to the beginning of the fiscal year	The organization should submit this for each year during the funding period for approval by showing the following: • Total amount of the organization's planned expenditures on its program administration costs. The plan must also show a breakdown of that amount showing the amount planned for program administration costs, and capacity building costs related to Employment Insurance activities and not related to Employment Insurance activities. • Total amount of the organization's planned expenditures on its program assistance costs and a breakdown of that amount between Labour Market Programs, Youth Programs, Child Care Program, and Program for Persons with Disabilities. • A further breakdown of Labor Market Programs planned expenditures on Employment Insurance related assistance costs and the other program assistance costs.
Accounting of the contributions Monthly/quarterly	Before an advance is issued for the 3rd month/quarter and each one after that, the organization must submit an account for the contributions for the month/quarter ending one month/quarter prior to the period for which the advance is to be paid.
Annual Audit Report Within 90 days of the end of the fiscal year	The organization must engage an accounting firm to provide this report during the funding period. It should include the following: • Audited financial statements for the fiscal year. • List of adjustments and reclassifications required to the general ledger with an explanation of each one. • Identification of unexpended balances of advances. • Identification of other income relative to the Agreement such as interest earned and GST rebates. • List of any claimed expenses which are not supported by adequate documentation. • List of all capital assets worth over $250 that were leased or purchased with contribution funds. The list must include, the name, whether it is a lease or purchase, date of purchase/lease, costs and serial number. • Opinion on the adequacy of the internal financial management procedures and controls. • Opinion on the effectiveness of the program monitoring. • Suggestions for ways to improve any deficiencies noted in the opinions. • Comments on the steps taken to remedy any deficiencies noted in previous reports.

Name of report and frequency	Report description
	CMHC requirements / non-financial reports
Post-1997 projects	
Other information from time to time, as requested	Information relating to the project and project units that may be reasonably required by CMHC, within a mutually agreed upon time frame that is reasonable in the circumstances.
Environmental Site Assessment (Phase 1 report) On application for *National Housing Act* (NHA), section 95, Assistance	Each capital project application involving more than six housing units (or multi-storey projects) must undertake, as part of its application proposal, an Environmental Site Assessment (ESA) Phase 1 investigation as described in Canadian Standards Association standard CSA Z768. The purpose of the Phase 1 is to ensure that there is no evidence of contamination on the sites considered for housing units which may constitute an identifiable risk to human health or the natural environment. The ESA report is required as a condition of project approval and will be required prior to issuance of loan advances.
Evidence that per diem rates or grants will be available for the operating costs of the non-shelter component of the project On application for NHA section 95, Assistance	For care facilities/special purpose housing: • Evidence required so that, with the subsidy, the project as a whole will operate on a break-even basis.
Pre-1997 projects	
Project Data Report (CMHC 2254) Annually (within four months after the fiscal year-end)	Required for the pre-1997 section 95 subsidized housing portfolio (two percent program). Only the Tenant Profile portion of the form (CMHC 2254) is required to be completed. It is not necessary to involve the auditor in the completion of the form.

Name of report and frequency	Report description
	CMHC Requirements / financial
Post-1997 projects	
Audited financial statements Annually (within four months after the end of the fiscal year)	The statement must be in a format acceptable to CMHC and prepared by an independent accredited auditor. The duties of the First Nation's auditor must include, but may not be limited to the following: • Verification of the statement of revenue and expenditure. • Verification of the balance sheet. • The provision of an auditor's report including any internal control letter or other auditor's letter presented to the First Nation. • The provision of a statement of changes in financial position. • The provision of a statement to the effect that the Replacement Reserve fund has been properly funded and maintained, and that all interest earned by the fund has been accrued to and maintained with the fund. • Confirmation that disbursements from the Replacement Reserve fund have been made for items of a capital nature in accordance with the Replacement Reserve Criteria as outlined in Schedule "D." There should also be confirmation that items not on the standard list (exceptions) have received prior CMHC approval, along with the provision of an itemized listing of the Replacement Reserve expenditures for the year including the item and the cost. • The provision of a statement to the effect that the Operating Reserve fund has been properly funded and maintained, and that all interest earned by the fund has been accrued to, and maintained with the fund in compliance with clause 8 above. • The provisions of standard notes to the financial statements. Replacement Reserve Fund The sponsor's auditor must confirm the following: • Disbursements from the Replacement Reserve Fund have been made for items of a capital nature in accordance with the criteria and standard list. • The Procurement criteria have been adhered to. • Items not on the standard list (exceptions) have received prior CMHC approval.
Audited statement of "final" capital costs One-time requirement at project completion	Where the statement has not been received with six months CMHC may withhold subsidy payments.

Name of report and frequency	Report description
	CMHC Requirements / financial
Pre-1997 projects	
Audited financial statements Within four months after fiscal year-end	The duties of the Recipient's auditor shall include the following: • Verification of the statement of revenue or expenses and where applicable, separate statements of revenue or expenses of the shelter and non-shelter components of the project. • Verification of the balance sheet. • Production of a statement indicating whether or not verification of the incomes of the occupants and the rent calculations as required by clause 2(5) have been undertaken. This is provided that such an assessment may be undertaken, by the auditor on a sample basis. • Verification of the Annual Project Data Report. • The provision of an auditor's report. • The provision of a statement to the effect that the Replacement Reserve Fund and the Subsidy Surplus Fund have been properly funded and maintained, and that all interest accruing to these funds has been recorded. When the above-noted financial statements have not been received, CMHC may suspend subsidy payments.

Appendix B Information from First Nations reported to Parliament

This appendix compares the information Indian and Northern Affairs Canada, Health Canada and Human Resources Development Canada reported to Parliament (in reports on plans and priorities from 1998–99 to 2002–03, and in departmental performance reports from 1999 to 2001) with the non-financial data collected from First Nations in Saskatchewan (see Appendix A).

As indicated in paragraph 1.77, federal organizations do not need to report to Parliament in detail on First Nations program activities; what is needed is more information on results.

Programs examined	Summary of information reported in estimates documents
Indian and Northern Affairs Canada	
Indian registration	• Departmental performance reports commonly provide information on the age profile of the Registered Indian population, the proportion of on-reserve vs. off-reserve Status Indians, and the growth rate of the on-reserve Status Indian population.
Education	• The most commonly reported information is the percentage of the relevant population participation, the breakdown of school attendance (on-reserve vs. off-reserve), and the number of education reform projects. • In the 1999 *Performance Report*, information was presented on Indian language instruction, special education needs, and curriculum enhancement initiatives. • There was no reporting on the certification of teachers, amounts spent on students attending off-reserve schools, detailed school evaluations, or numbers and reasons for students not returning to school. • Information reported on post-secondary education is mainly enrolment numbers from year to year and comparisons to Canadian enrolment as a whole. There is no reporting on the type or amount of post-secondary education completed (that is, diplomas or degrees), numbers being funded, or graduation statistics.
Social development	• Data regarding the number of income security demonstration projects that were underlay during the relevant year is the only information collected from First Nations that is reported consistently. • In the 1999 *Performance Report*, the social assistance dependency rate was reported; in the 2001 *Performance Report*, the number of beneficiaries assisted per month was reported. • The 2001 *Performance Report* reported the National Child Benefit Program amount re-invested, the number of programs funded, and the number of families and children affected. • None of the data collected on Indian Child and Family Services, Adult Care, or tribal council funding were reported.
Indian government support	• The only information reported on Band Support Funding is the dollar value of program expenditures.

Programs examined	Summary of information reported in estimates documents
Capital	• The most commonly reported information related to the expansion of on-reserve schools from year to year and planned vs. actual spending on capital projects. • Information consistently reported on Housing and Infrastructure initiatives included data on housing adequacy, water delivery systems, and sewage disposal systems. • The 1999 and 2000 departmental performance reports reported the number of houses completed and renovations made during the year. • In the 2001 *Performance Report*, the actual number of housing units was reported.
Economic development	• Information generally reported included data on the number/dollar value of federal contracts awarded to Aboriginal businesses, Opportunity Fund projects funded and number of jobs resulting, the number of resource-based projects funded, and general information on partnership projects. • Information reported less frequently included the number of projects from Resource Acquisition Funding, jobs created, and business expansion.
Health Canada	
All Aboriginal programs	• In general, Health Canada lumps spending on all Aboriginal programs into one amount and does not report the breakdown of the individual spending per program with the exception of: • 1999–2000 *Report on Plans and Priorities* – Budget for the Aboriginal Diabetes Initiative. • 1999–2000 *Report on Plans and Priorities* – Budget for Home and Community Care. • 1999 *Performance Report* – Budget for Aboriginal Head Start On-Reserve over 4 years. • 2001 *Performance Report* – Contribution towards the Aboriginal Head Start On-Reserve.
Aboriginal Diabetes Initiative	• Since the Initiative was announced in the 1999 budget, the only information reported consistently related to the gathered information is the basic status of the project. Also, the number of projects funded was reported in two of the years (departmental performance reports for 2000 and 2001). • There was no reporting on detailed information such as the number of clients assisted, partnerships, linkages to other programs, and any detailed expenditures.
Aboriginal Head Start on Reserve	• The only information reported was the number of projects funded in the 1999 and 2000 departmental performance reports. • As well, the 2000 *Performance Report* reported on the number of children the project served and an evaluation initiative taken. • All other information gathered from First Nations was not used.
Home and Community Care (HCC)	• Information consistently reported included the status of the program in general. • The 2001 *Performance Report* reported on data collected on the stages of the program such as the percentage of eligible communities that have completed the HCC program needs assessment, finalized service delivery plans, and that are actually providing services.
Tuberculosis Elimination Strategy	• No specific information was reported.

Programs examined	Summary of information reported in estimates documents
Human Resources Development Canada	
Aboriginal Human Resources Development Agreement (AHRDA) Program	• 1998–99 *Report on Plans and Priorities* and 1999 *Performance Report* reported a general goal to develop the Aboriginal Human Resource Development Agreement Program in the following years. • The 2000 *Performance Report* reported on the actual total spending on the program and a statement that the program was implemented after setting a specific goal of the amount of agreements to be signed (1999–2000 *Report on Plans and Priorities*). • The 2000-2001 *Report on Plans and Priorities* and 2001 *Performance Report* reported on goals and results produced during the year which reflected information gathered from AHRDA-holders. Financially, the goal and the result of total spending was reported along with a breakdown of a goal reported for spending on childcare. Goals and results for the number of Aboriginals assisted during the year, numbers returning to school, numbers becoming employed, and savings to the EI account were reported related to data gathered throughout the year. • Information that was gathered from First Nations but not reported in the Estimates documents, included data on the breakdown of planned or actual expenses related to costs of Employment-Insurance and non-Employment Insurance activities. The Estimates documents also did not include: information from audit reports; participant information; specifics on programs; information from the monthly/quarterly progress reports including targets vs. results on various data collected; and any information from the annual report.

Report of the Auditor General of Canada to the House of Commons—December 2002

Main Table of Contents

Matters of Special Importance—2002
Foreword and Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada—Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada—Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

Appendices

2002

Report of the
Auditor General of Canada
to the House of Commons

DECEMBER

Chapter 2
Fisheries and Oceans Canada—
Contributing to Safe and Efficient Marine Navigation

Office of the Auditor General of Canada

The December 2002 Report of the Auditor General of Canada comprises 11 chapters, Matters of Special Importance—2002, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

Ce document est également disponible en français.

© Minister of Public Works and Government Services Canada 2002
Cat. No. FA1-2002/2-10E
ISBN 0-662-33108-7

Chapter

2

Fisheries and Oceans Canada

Contributing to Safe and Efficient Marine Navigation

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

Table of Contents

Main Points 1

Introduction 3

The government's role in the marine transportation system is complex 3
Canada must meet national and international responsibilities 5
Important trends have impacted the Department's delivery of marine navigational support 5
The Department plays a limited role in marine security 6
Focus of the audit 6

Observations and Recommendations 7

There is a need to modernize 7
Technology and user needs are changing rapidly 7
The Department consults with users 8
The Department is aware of the need for change 8

There are barriers to change 9
The Coast Guard's headquarters has not ensured that there is one national program 9
There are five regional coast guards 12
Key elements are not present to ensure accountability 13
Risks to safety and efficiency have not been regularly assessed 17
Service delivery is not integrated 17
Outdated legislation is used for unintended purposes 18
Activities undertaken that do not support safety and efficiency 18
There is limited focus on a core mandate 19
The Marine Services Fees have created a difficult relationship with industry 21

Our Office has said this before 22

Conclusion 22

About the Audit 25

Appendix

Key findings from our 1983 Report on the Canadian Coast Guard's preventive responsibilities 26

Fisheries and Oceans Canada

Contributing to Safe and Efficient Marine Navigation

Main Points

2.1 Fisheries and Oceans Canada is one of several departments and agencies that contribute toward the safe and efficient navigation of vessels in Canada's waterways. We focussed on the Department's role in preventing accidents and supporting the efficient navigation of our waterways.

2.2 We found that users of Canada's navigational support services generally consider them to support safe waterways and provide services that generally meet their navigational requirements. However, the Department has limited performance information that shows how it contributes to safe and efficient marine navigation. The Department has not cost-effectively managed the functions we examined and changes must be made to ensure the services continue to meet user needs in the future.

2.3 The Department faces changing service demands, evolving waterway usage, continuing fiscal pressure, and increasing technological demands because of international obligations and advances in the shipping industry.

2.4 There are significant barriers preventing the Department from modernizing and delivering its navigational support services and boating safety activities cost-effectively, including

- failure to ensure that there is one national program,
- regional operations that are not held accountable for implementing national policies and meeting international obligations,
- key elements not present to ensure accountability,
- inadequate integration of navigational support services,
- provision of a service that does not contribute to the mandate for safety and efficiency, and
- outdated legislation used for unintended purposes.

2.5 While new technologies and services have been introduced since 1983, many of our current observations about the Canadian Coast Guard are similar to observations in our 1983 Report, Chapter 13, Marine Transportation Program, and in our 2000 Report, Chapter 31, Fleet Management. We are concerned that the Department has not yet dealt with these management issues.

Background and other observations

2.6 The Department carries out both preventive and responsive activities to support its commitment to maritime safety and efficient use of Canada's waterways. In this audit, we examined the preventive aspects of the

Department's commitment to safe and efficient waterways. We examined two important parts of these responsibilities: navigational support services and recreational boating safety.

2.7 The navigational support services that we examined included aids to navigation, channel maintenance, waterways protection, marine communications and traffic services, and navigational charts. The recreational boating safety activities that we examined included the programs that support the promotion of boating safety and the regulation of the construction, inspection, equipment, and operation of pleasure craft.

2.8 The activities that we examined had total estimated expenditures of $220 million (unaudited) in 2001–02. In addition, there were approximately $30 million (unaudited) in revenues, mostly associated with the Marine Services Fees.

2.9 The implementation of the Marine Services Fees has created a difficult working relationship with the marine industry. There still appears to be an underlying belief by industry that the Canadian Coast Guard has not been able to change sufficiently to deal with its concerns and that the fee is too high for the services that are provided. However, the Marine Services Fees have had a positive effect through the increased role of the marine industry in determining service levels.

The Department has responded. Fisheries and Oceans Canada accepts our findings. The Department's response to our recommendations, included in this chapter, describes the actions it is taking or intends to take.

Introduction

2.10 Canada's marine transportation system is an important part of our economy, culture, and environment, and serves some important functions, including

- providing a global gateway to world markets;
- providing domestic transportation of goods and passengers;
- supporting all its users—fishers, recreational, and others;
- supporting military and other government activities; and
- supporting other economic activity, including aquaculture and oil and gas development.

2.11 The marine transportation system takes place within important ocean, coastal, and freshwater ecosystems, which are known as its natural infrastructure. These ecosystems support fish, marine mammal, and bird species. These waterways can also be important sources of water for human consumption. Exhibit 2.1 provides further information on the importance of the marine transportation system to Canadians.

Exhibit 2.1 The importance of the marine transportation system to Canadians

Marine freight traffic in 2000	349 million tonnes[1]
Percentage shipped, in terms of tonnage, by marine mode between Canada and overseas countries in 2001	over 90 percent[1]
Estimated number of Canadians participating in recreational boating in 2001	8 million[2]
Estimated number of recreational boats in 2001	2.7 million[2]
Total estimated ferry traffic in 2000	40 million passengers and 17 million vehicles[1]
Cruise ship passengers visiting Canada's five largest ports in 2001	1.4 million passengers[1]
Number of commercial fishing vessels in 1999	24,200[2]

Source: [1]Transport Canada
[2]Fisheries and Oceans Canada

2.12 While we have natural infrastructure, some waterways require investment to make them useable, including dredging, channel maintenance, and ice breaking. In addition, navigational support services such as regulations, charts, and navigational aids are required to make navigation of the waterways safe and commercially efficient.

The government's role in the marine transportation system is complex

2.13 The federal government plays an important role in ensuring the safety of users, contributing to Canadian competitiveness, preventing pollution, assisting with national security issues, and meeting international obligations.

Introduction

2.10 Canada's marine transportation system is an important part of our economy, culture, and environment, and serves some important functions, including

- providing a global gateway to world markets;
- providing domestic transportation of goods and passengers;
- supporting all its users—fishers, recreational, and others;
- supporting military and other government activities; and
- supporting other economic activity, including aquaculture and oil and gas development.

2.11 The marine transportation system takes place within important ocean, coastal, and freshwater ecosystems, which are known as its natural infrastructure. These ecosystems support fish, marine mammal, and bird species. These waterways can also be important sources of water for human consumption. Exhibit 2.1 provides further information on the importance of the marine transportation system to Canadians.

Exhibit 2.1 **The importance of the marine transportation system to Canadians**

Marine freight traffic in 2000	349 million tonnes[1]
Percentage shipped, in terms of tonnage, by marine mode between Canada and overseas countries in 2001	over 90 percent[1]
Estimated number of Canadians participating in recreational boating in 2001	8 million[2]
Estimated number of recreational boats in 2001	2.7 million[2]
Total estimated ferry traffic in 2000	40 million passengers and 17 million vehicles[1]
Cruise ship passengers visiting Canada's five largest ports in 2001	1.4 million passengers[1]
Number of commercial fishing vessels in 1999	24,200[2]

Sources: [1] Transport Canada
[2] Fisheries and Oceans Canada

2.12 While we have natural infrastructure, some waterways require investment to make them useable, including dredging, channel maintenance, and ice breaking. In addition, navigational support services such as regulations, charts, and navigational aids are required to make navigation of the waterways safe and commercially efficient.

The government's role in the marine transportation system is complex

2.13 The federal government plays an important role in ensuring the safety of users, contributing to Canadian competitiveness, preventing pollution, assisting with national security issues, and meeting international obligations.

Federal responsibility for managing Canada's marine transportation system is divided among many departments and agencies.

2.14 The complex nature of the government's role in the marine transportation system means that it is difficult to determine the relative contribution of each department or agency. Departments and agencies often indicate that they are contributing to the same objective; frequently, this objective is maritime safety.

2.15 Exhibit 2.2 shows the federal departments and agencies that play a major role in managing and regulating the marine transportation system.

Exhibit 2.2 Major federal responsibilities in Canada's marine transportation system

Transport Canada	• Regulation of commercial vessels and mariners. • Regulation of fishing vessels. • Ship safety inspection and other port state control functions. • Port and pilotage policy. • Lead department representing Canada's interest in international governing organizations (for example, the International Maritime Organization). • Lead department regarding transportation security issues.
Fisheries and Oceans Canada	• Regulation of recreational boats and boaters. • Provision of marine navigational services including marine communications and traffic services, aids to navigation, channel maintenance, navigable waters protection, navigational charts, and icebreaking. • Marine search and rescue, vessels. • Environmental response. • Fleet provides support to other government departments. • Harbours (financial support of core fishing harbours).
Canadian Transportation Agency	• Economic regulation of transportation under federal jurisdiction (for example, pilotage and port fees).
Transportation Safety Board of Canada	• Investigation and reporting on transportation accidents, including marine accidents.
Pilotage authorities	• Provision of pilotage service.
Port corporations or authorities	• Operation of ports.
National Defence	• Sovereignty and military security. • Marine search and rescue, coordination, aircraft, and vessels in a supporting role. • Support to other government departments.
Royal Canadian Mounted Police	• Policing, including boating safety.

[illegible]

Federal responsibility for managing Canada's marine transportation system is divided among many departments and agencies.

2.14 The complex nature of the government's role in the marine transportation system means that it is difficult to determine the relative contribution of each department or agency. Departments and agencies often indicate that they are contributing to the same objective; frequently this objective is maritime safety.

2.15 Exhibit 2.2 shows the federal departments and agencies that play a major role in managing and regulating the marine transportation system.

Exhibit 2.2 Major federal responsibilities in Canada's marine transportation system

Transport Canada	• Regulation of commercial vessels and mariners. • Regulation of fishing vessels. • Ship safety inspection and other port state control functions. • Port and pilotage policy. • Lead department representing Canada's interest in international governing organizations (for example, the International Maritime Organization). • Lead department regarding transportation security issues.
Fisheries and Oceans Canada	• Regulation of recreational boats and boaters. • Provision of marine navigational services including marine communications and traffic services, aids to navigation, channel maintenance, navigable waters protection, navigational charts, and icebreaking. • Marine search and rescue, vessels. • Environmental response. • Fleet provides support to other government departments. • Harbours (financial support of core fishing harbours).
Canadian Transportation Agency	• Economic regulation of transportation under federal jurisdiction (for example, pilotage and port fees).
Transportation Safety Board of Canada	• Investigation and reporting on transportation accidents, including marine accidents.
Pilotage authorities	• Provision of pilotage service.
Port corporations or authorities	• Operation of ports.
National Defence	• Sovereignty and military security. • Marine search and rescue, coordination, aircraft, and vessels in a supporting role. • Support to other government departments.
Royal Canadian Mounted Police	• Policing, including boating safety.

Source: Relevant legislation, departmental performance reports, and annual reports

Canada must meet national and international responsibilities

2.16 The *Oceans Act* gives Fisheries and Oceans Canada the authority to provide a coast guard and hydrographic service. Under section 40 (2) of the Act, the Minister of Fisheries and Oceans will provide

> . . . coast guard and hydrographic services to ensure the facilitation of marine trade, commerce and safety in collaboration with other ministers of the Government of Canada.

2.17 The *Canada Shipping Act* gives the Minister of Fisheries and Oceans specific responsibility for providing aids to navigation and vessel traffic services, and regulating pleasure craft operation.

2.18 The basic expectations for navigational support services are set out in the International Convention for the Safety of Life at Sea (SOLAS Convention). Canada is a signatory to this international convention, which governs large commercial vessels operating in multiple jurisdictions. Transport Canada establishes regulations that set out the navigational equipment requirements for commercial vessels operating only in Canadian waters. These regulations can be different from the SOLAS requirements. Therefore, the Coast Guard must tailor its programs to meet both SOLAS and domestic requirements.

2.19 The SOLAS Convention sets out the types of navigational support services that signatory nations must provide. However, the actual design of the specific navigational support systems is left to the individual countries. A country that does not provide navigational support is not likely to receive significant traffic from SOLAS vessels. These vessels account for most of Canada's commercial vessel traffic to overseas countries and as a major trading nation, it is in our national interest to provide the necessary support for these vessels.

2.20 Other international non-governmental organizations provide technical advice and guidance on the delivery of navigational support services. These organizations have mainly focussed on the needs of SOLAS vessels. Canada does not have to follow this guidance; however, these are the minimum internationally recognized performance standards.

2.21 There is limited international guidance for the navigational support needs of pleasure craft and other operators. Fisheries and Oceans Canada and Transport Canada jointly determine the navigational needs of pleasure craft, domestic commercial shippers, and other operators, after consultation with national/regional user group representatives.

Important trends have impacted the Department's delivery of marine navigational support

2.22 Historically, marine navigation support systems have been designed primarily to reduce risks associated with commercial shipping. Canada has seen a gradual but steady increase in the number of people using our waterways for recreational purposes. Recreational boaters tend to have less training and less sophisticated navigational equipment on their boats than commercial vessels.

2.23 The 1990s saw a revolution in marine navigational technology, affecting both the safety and efficiency of navigation. For example, satellite-based global positioning and advances in communications have led to the development of many other new technologies. Many vessels now make use of electronic navigational charts that are integrated into their navigational guidance equipment.

2.24 Fisheries and Oceans Canada has had to provide support for modern navigational systems. In addition, there are new technologies being developed that will further revolutionize marine navigation. While new systems have been introduced, the Department cannot eliminate all of the older systems as there is continuing demand from some users or a need for reliable backup.

2.25 Since 1994, the Department has had to operate under significant fiscal restraint. The 1995 merger of the Canadian Coast Guard into Fisheries and Oceans Canada's operations has been challenging because of the different corporate cultures. In addition, savings anticipated from the merger have not been fully realized, although funding has already been reduced.

2.26 In 1996 the government introduced the Marine Services Fees to recover part of the cost of providing marine navigational support to the commercial shipping industry. These fees have contributed to a difficult working relationship between government and industry.

The Department plays a limited role in marine security

2.27 Transport Canada is responsible for leadership in marine security issues. Currently, Fisheries and Oceans Canada is mainly responsible for supporting other departments and agencies in matters of marine security. This includes the collection and dissemination of information through the Marine Communications and Traffic Services centres, aerial surveillance, and the presence of Coast Guard vessels on our waterways.

Focus of the audit

2.28 The audit focussed on the following preventive aspects of Fisheries and Oceans Canada's commitment to safe and efficient waterways:

- aids to navigation;
- channel maintenance;
- navigable waters protection;
- marine communications and traffic services;
- navigational charts, publications, digital and other navigational information; and
- boating safety, including promotion and regulation of the construction, inspection, equipment, and operation of pleasure craft.

These activities are carried out by the Canadian Coast Guard, including its Office of Boating Safety and the Canadian Hydrographic Service, which are all part of Fisheries and Oceans Canada.

2.29 Our audit objective was to assess the extent to which Fisheries and Oceans Canada's management of its preventive activities supports its commitment to provide for safe and efficient waterways in a cost-effective manner. Exhibit 2.3 shows Fisheries and Oceans Canada's estimate of the 2001–02 cost of the activities that we examined.

Exhibit 2.3 The estimated cost of Fisheries and Oceans Canada's 2001–02 preventive activities

Preventive activities	Gross expenditures[1] (millions)
Navigational Support Services	
Canadian Coast Guard	
• Marine Navigation Services	$ 109
• Marine Communications and Traffic Services	60
Canadian Hydrographic Service	41
Total	210
Boating Safety	
Canadian Coast Guard	
• Office of Boating Safety	10
Total	**$ 220**

[1] Gross expenditures are unaudited and do not include capital expenditures.

Source: Fisheries and Oceans Canada

Observations and Recommendations

There is a need to modernize

Technology and user needs are changing rapidly

2.30 Marine navigation has been greatly affected by rapid and accelerating technological development. Satellite global positioning technology has helped the marine industry to develop new navigational tools for safer and more efficient navigation. Modern commercial vessels use sophisticated equipment based on this technology. Even fishers and pleasure craft operators are increasingly using new technology to navigate their vessels. Many users are demanding that Fisheries and Oceans Canada provide the infrastructure and tools to support new technologies.

2.31 The introduction of the Marine Services Fees, designed to recover a portion of the cost of certain navigational support services provided to commercial shippers, has led industry to believe that other governance arrangements would lead to a more cost-effective service. Industry expects that the Coast Guard's operations should be made more cost-effective, at the very least.

2.29 Our audit objective was to assess the extent to which Fisheries and Oceans Canada's management of its preventive activities supports its commitment to provide for safe and efficient waterways in a cost-effective manner. Exhibit 2.3 shows Fisheries and Oceans Canada's estimate of the 2001–02 cost of the activities that we examined.

Exhibit 2.3 **The estimated cost of Fisheries and Oceans Canada's 2001–02 preventive activities**

Preventive activities	Gross expenditures[1] (millions)
Navigational Support Services	
Canadian Coast Guard	
• Marine Navigation Services	$ 109
• Marine Communications and Traffic Services	60
Canadian Hydrographic Service	41
Total	210
Boating Safety	
Canadian Coast Guard	
• Office of Boating Safety	10
Total	**$ 220**

[1] Gross expenditures [illegible]

Source: Fisheries and Oceans Canada

Observations and Recommendations

There is a need to modernize

Technology and user needs are changing rapidly

2.30 Marine navigation has been greatly affected by rapid and accelerating technological development. Satellite global positioning technology has helped the marine industry to develop new navigational tools for safer and more efficient navigation. Modern commercial vessels use sophisticated equipment based on this technology. Even fishers and pleasure craft operators are increasingly using new technology to navigate their vessels. Many users are demanding that Fisheries and Oceans Canada provide the infrastructure and tools to support new technologies.

2.31 The introduction of the Marine Services Fees, designed to recover a portion of the cost of certain navigational support services provided to commercial shippers, has led industry to believe that other governance arrangements would lead to a more cost-effective service. Industry expects that the Coast Guard's operations should be made more cost-effective, at the very least.

The Department consults with users

2.32 The implementation of the Marine Services Fees led to the revitalization of several useful national and regional forums for consultation with user groups. Transport Canada and Fisheries and Oceans Canada co-ordinate certain user group consultations.

2.33 However, the interests of the user groups can be region specific. The interests of the Pacific, the Great Lakes, and the St. Lawrence River industry groups can be quite different from each other. For example, there are different climate conditions, cargoes, and seasonal services. The Department must be able to identify and understand regional needs while still operating cost-effectively and ensuring that it meets national and international requirements.

The Department is aware of the need for change

2.34 For several years, the Department has recognized the need to modernize its operations. The Canadian Coast Guard is looking to leverage technology and make better use of its asset and human resource base in order to achieve a more cost-effective service. However, progress has been slow. In 2001, a Coast Guard modernization initiative was started, incorporating the following four elements:

- Fleet Management Improvement;
- Integrated Technical Support Strategy;
- Marine Aids Modernization Vision 2001, a continuation of an earlier initiative; and
- Electronic Navigation.

2.35 The concept of the Electronic Navigation initiative is not yet developed. The other initiatives are at various stages of progress but none is fully implemented.

2.36 The Canadian Hydrographic Service has also recognized that there are problems with its hydrographic program. There is a continuing need to clear a backlog in Notices to Mariners, which are a source of information on critical changes to navigational risks on waterways. In addition, only approximately 50 percent of Canada's southern waters and 20 percent of northern waters are surveyed to modern international standards. Many charts are not compatible with modern navigation techniques. In March 2001, the Department obtained $14.4 million in supplementary funding over two years to address these issues. However, the Canadian Hydrographic Service has identified a total of $49.5 million in work over five years that is needed to address these problems. The Canadian Hydrographic Service has informed us that its existing resources will not be enough for it to address all of the issues that it has identified.

2.37 The Coast Guard has not yet developed a comprehensive plan for its Marine Communications and Traffic Services operations. It is possible that Marine Communications and Traffic Services centres could be further consolidated and new automated technologies introduced. These changes would affect the number and location of employees and the types of skills needed. Alternative means of providing navigational aids could have a similar impact. As part of planning for changes, the Coast Guard must assess the impact on its operations and implement national strategies to deal with it.

There are barriers to change

2.38 Although the Department has identified the need to modernize and improve delivery of its navigational support services and boating safety activities, we found that there are significant barriers that prevent the Department from making the required improvements.

The Coast Guard's headquarters has not ensured that there is one national program

2.39 Under the Department's management model, each program area within the Canadian Coast Guard's headquarters is responsible for setting national objectives, policies, standards and procedures, and monitoring the performance of regional operations. In April 2000, the Coast Guard's headquarters was reorganized. This reorganization was intended to improve service to the regions, eliminate overlap between the Coast Guard and the rest of the Department's headquarters, and facilitate staffing on an indeterminate basis.

2.40 During the course of our audit, we found that most of the headquarters staff that we spoke to had only recently assumed their responsibilities, many positions had yet to be staffed, and or the national functional areas had been inactive for some time. Some areas were more advanced than others. For example, the aids to navigation area had put the Marine Aids Modernization Vision 2001 in place and set out national direction for this area. The Marine Communications and Traffic Services area was just beginning to develop a long-term strategy and update levels of service expectations. Other service areas were just being organized, such as Integrated Technical Services, which is responsible for purchasing, maintaining, and repairing the Coast Guard's equipment.

2.41 In some cases, national standards are just being developed or updated. There has been little national guidance to help make levels of service decisions in relation to risk.

2.42 The Coast Guard's headquarters has only limited means to ensure that national standards or targets are met. There is limited regular reporting of either financial or non-financial information relating to expected levels of service. Quality assurance is an important role that is delegated to headquarters groups under the management model. However, there is no quality assurance function in headquarters. Without national goals, standards, and a monitoring capability, the Department has no way to hold managers accountable for their performance.

2.43 This lack of national leadership has had consequences. For example, the lack of a national Marine Communications and Traffic Services strategy has resulted in regions implementing their own approaches. This in turn has led to duplication of effort and the implementation of information systems that do not meet national requirements. Information and control systems were developed by two regions to help monitor and communicate with mariners (case study, "Two information systems serving the same purpose"). Each of these systems fulfills its role; however, there is no need for two separate systems.

2.44 The Canadian Coast Guard reduced the number of Marine Communications and Traffic Services centres from 44 to 22 in the mid-1990s. It is possible that modern technology could allow the Coast Guard to reduce the number of centres even further. While the overall resource requirements, including salaries, have not been quantified, a reduction in the number of centres could have an impact on overtime and other human resource issues. The Coast Guard estimates that 22 percent of its current staff will leave their jobs because of retirement or other reasons over the next four years. Existing communications equipment will require replacement or upgrades. The Coast Guard has recognized this issue and recently started a national review of its Marine Communication and Traffic Services business line.

Two information systems serving the same purpose

Background

Canada's 22 Marine Communications and Traffic Services centres give vital support to mariners by providing marine navigational information, monitoring vessel movement, and supporting marine communication. Operators involved in monitoring traffic movements integrate information from a number of sources such as radar screens, radio communications with ships, navigational charts, ship transit data, and other sources. The Canadian Coast Guard has been working towards a better means of integrating these various sources of information.

Development of two integrated information systems

In August 1995, the Laurentian Region, now the Quebec Region, obtained authority from Coast Guard headquarters to begin the development of the Information System on Marine Navigation (INNAV). The first stage of the project was planned for completion in 1998 at an estimated direct cost of $7.3 million. This stage was the delivery of a fully integrated real-time information system that would be installed in six centres in eastern Canada. The Region encountered several project management problems that resulted in cost overruns and delays in project completion. In 1999 the project became the responsibility of the Integrated Technical Services unit at headquarters. It reduced the scope of the project to activities that directly supported marine communications and traffic services and that could be completed by May 2001.

In April 2002, the first stage of INNAV was installed in eight centres in eastern Canada. The total estimated direct cost of the project increased to $13 million. The Department has informed us that INNAV is meeting user needs even though some of the original system capability was not delivered.

Over the last fifteen years, the Pacific Region has been developing systems to maintain historical records of vessel movements. Its various incrementally developed systems have evolved into its own integrated information system called the Vessel Traffic Operational Support System (VTOSS). The Pacific Region did not seek national approval for the development of VTOSS and funded it out of regional operating budgets. The Region indicates that the system meets its needs; however, a formal systems development approach was not used, resulting in an almost total lack of systems documentation. In addition, VTOSS is dependent on the employee who developed it for maintenance.

VTOSS and INNAV are not linked; therefore, information cannot be transferred between the two systems. The Marine Communications and Traffic Services headquarters must combine information from the two systems to prepare statistical reports on national program activity. The Department is now confronted with the cost of operating and maintaining two systems that are designed to serve the same purpose.

Our concern

This case study illustrates the consequences of a lack of national leadership in developing important information systems. Both regions used poor project management practices and, in the end, the Department has paid for two systems where only one national system is required.

that do not meet national requirements. Information and control systems were developed by two regions to help monitor and communicate with mariners (case study, "Two information systems serving the same purpose"). Each of these systems fulfills its role; however, there is no need for two separate systems.

2.44 The Canadian Coast Guard reduced the number of Marine Communications and Traffic Services centres from 44 to 22 in the mid-1990s. It is possible that modern technology could allow the Coast Guard to reduce the number of centres even further. While the overall resource requirements, including salaries, have not been quantified, a reduction in the number of centres could have an impact on overtime and other human resource issues. The Coast Guard estimates that 22 percent of its current staff will leave their jobs because of retirement or other reasons over the next four years. Existing communications equipment will require replacement or upgrades. The Coast Guard has recognized this issue and recently started a national review of its Marine Communication and Traffic Services business line.

Two information systems serving the same purpose

Background

Canada's 22 Marine Communications and Traffic Services centres give vital support to mariners by providing marine navigational information, monitoring vessel movement, and supporting marine communication. Operators involved in monitoring traffic movements integrate information from a number of sources such as radar screens, radio communications with ships, navigational charts, ship transit data, and other sources. The Canadian Coast Guard has been working towards a better means of integrating these various sources of information.

Development of two integrated information systems

In August 1995, the Laurentian Region, now the Quebec Region, obtained authority from Coast Guard headquarters to begin the development of the Information System on Marine Navigation (INNAV). The first stage of the project was planned for completion in 1998 at an estimated direct cost of $7.3 million. This stage was the delivery of a fully integrated real-time information system that would be installed in six centres in eastern Canada.

The Region encountered several project management problems that resulted in cost overruns and delays in project completion. In 1999 the project became the responsibility of the Integrated Technical Services unit at headquarters. It reduced the scope of the project to activities that directly supported marine communications and traffic services and that could be completed by May 2001.

In April 2002, the first stage of INNAV was installed in eight centres in eastern Canada. The total estimated direct cost of the project increased to $13 million. The Department has informed us that INNAV is meeting user needs even though some of the original system capability was not delivered.

Over the last fifteen years, the Pacific Region has been developing systems to maintain historical records of vessel movements. Its various incrementally developed systems have evolved into its own integrated information system called the Vessel Traffic Operational Support System (VTOSS). The Pacific Region did not seek national approval for the development of VTOSS and funded it out of regional operating budgets. The Region indicates that the system meets its needs; however, a formal systems development approach was not used, resulting in an almost total lack of systems documentation. In addition, VTOSS is dependent on the employee who developed it for maintenance.

VTOSS and INNAV are not linked; therefore, information cannot be transferred between the two systems. The Marine Communications and Traffic Services headquarters must combine information from the two systems to prepare statistical reports on national program activity. The Department is now confronted with the cost of operating and maintaining two systems that are designed to serve the same purpose.

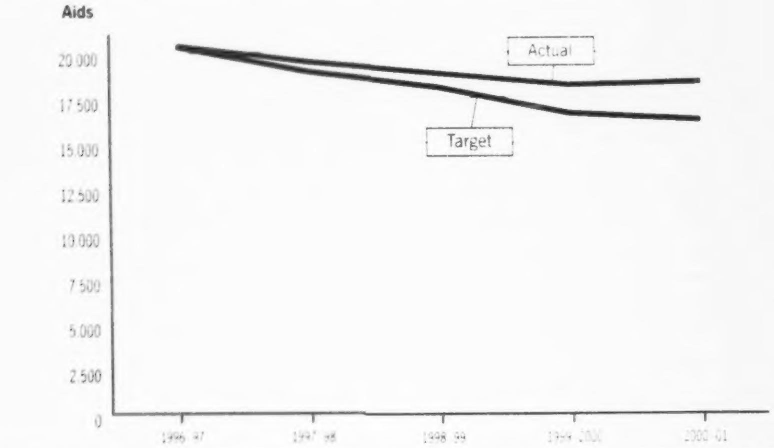
Our concern

This case study illustrates the consequences of a lack of national leadership in developing important information systems. Both regions used poor project management practices and, in the end, the Department has paid for two systems where only one national system is required.

2.45 In 1996, in response to Program Review, the Coast Guard initiated the Marine Aids Modernization initiative. Through this initiative and its successor, Marine Aids Modernization Vision 2001, the Coast Guard expected to achieve significant savings by rationalizing and modernizing its systems of aids to navigation. The Coast Guard is making progress on the Marine Aids Modernization initiative but is not moving as quickly as anticipated by the Program Review decision. It has made advances in certain areas such as solarization, high performance paints, and long life lights. However, reductions in the number of aids to navigation have been less than expected and aids to navigation must be serviced more frequently than planned. In addition, the reliability of the year-round floating lighted aids to navigation, a focus of the initiative, is below the national reliability standard. The Coast Guard recognizes that its aids to navigation funding requirements exceed the resources available. It has had to obtain funding from other sources within its own budgets or delay aids to navigation service delivery. Exhibit 2.4 shows the shortfall in the number of short-range aids to navigation removed compared the number planned for removal under the Marine Aids Modernization initiatives.

2.46 We also found that the Coast Guard operates and make decisions differently from region to region. For example, none of the regions have followed the national policy to review each short-range aid to navigation system. This includes a review of all the aids to navigation in a waterway at least once every five years. National peer reviews that were designed to determine regional compliance with national policies have not been performed since 1999.

Exhibit 2.4 Reduction in short-range aids to navigation compared with plan



	1996–97	1997–98	1998–99	1999–2000	2000–01
— Actual	20 354	19 478	18 811	18 162	18 337
— Target	20 338	18 957	18 064	16 610	16 244

Source: Fisheries and Oceans Canada

2.47 Coast Guard headquarters has not been providing the leadership envisaged in the Department's management model. There are a number of headquarters initiatives underway designed to have an impact on national leadership (paragraph 2.34).

There are five regional coast guards

2.48 We repeatedly observed that each of the Department's regions operate differently from the others. We expected some differences according to the needs of users in each region; however, we are concerned about the extent of the variation in practices. This is especially important given the Department's responsibility to meet national and international requirements.

2.49 For example, we expected that there would be standardized planning for capital intensive areas such as the 22 Marine Communications and Traffic Services centres across the country. Instead, we found that the planning for the centres is largely regionally based with very little common purchasing or maintenance approaches. This has resulted in a multiplicity of equipment and systems across the country. Each region needs to have its own technical support that is capable of maintaining the local systems.

2.50 We observed that regions responded to the interests of regional user groups by starting pilot projects that did not necessarily support national requirements. For example, the Pacific Region has participated in communications pilot projects for its Marine Communications and Traffic Service centres, including the development of a regional Automatic Identification System. Problems can arise when a region pursues pilot projects independent of national and international standards and direction (case study, "Lack of national co-ordination for pilot projects").

2.51 Regions can redirect budgets and resources from national to regional issues, depending on priorities. For example, the Maritimes Region has redirected its already limited resources from its aids to navigation program to other priorities, including fisheries issues. One impact of this has been that buoys that primarily service the needs of fishers were not put into the water until after the start of important fisheries. Subsequently, they were not removed from the water before ice formed in the winter, resulting in the loss of many buoys.

2.52 Focus on specific regional interests may be done at the expense of the national program. This practice can also undermine the long-term interests of all the user groups by weakening the Department's ability to respond nationally.

2.53 **Recommendation.** The Canadian Coast Guard should ensure that there are up-to-date national policies, standards, and levels of service expectations for its navigational support services. It should also develop the capability to monitor the implementation of these policies, standards, and expectations.

Key elements are not present to ensure accountability

2.54 The primary strategic objective of the activities we audited is to contribute to maritime safety and efficiency of navigation. We found that users of Canada's navigational support services generally consider them to support safe waterways and provide services that generally meet their navigational requirements. However, the Department has limited performance information to show how it contributes to these objectives.

Lack of national co-ordination for pilot projects

Background

The international marine community has been conducting ongoing research into integrating modern technologies such as global positioning, satellite communication, and advanced Very High Frequency radio communication. The term Automatic Identification System is now used to represent a new system that will provide mariners with real time, ship-to-ship and ship-to-shore digital navigation information.

Canada, largely through the Canadian Coast Guard, has conducted its own research into this system.

In 1994, Coast Guard headquarters, in consultation with industry, began its first study of it, including a 1996 pilot project on the St. Lawrence River.

The project final report, issued in August 1997, supported implementation of the system in Canadian waters. It also recommended that the Coast Guard and industry assess, on a national basis, the benefits and feasibility of its implementation. It concluded that there was a need to optimize the use of the existing marine communications equipment.

In addition, this project assessed the strengths and weaknesses of two competing radio technologies being considered internationally as a key part of the Automatic Identification System infrastructure. The study supported the use of the technology that was the strongest candidate for an international standard. Subsequently, this technology has been adopted as the international standard.

Pacific Region pilot project

In 1997, the Pacific Region, in collaboration with the local industry advisory group, began testing a system that was similar to the Automatic Identification System. However, it used radio technology different from the eventual international standard.

The pilot project built on technology that was being used to monitor tug activity on the West Coast. The Pacific Region and the local industry advisory group have been trying to broaden the applications that the system could support. However, despite the 1997 recommendations from the national study, the Pacific Region continued to provide support to this pilot project for a further two years.

Starting in 2000, the Pacific Region attempted to integrate the pilot project technology into its existing information and control system (case study, "Two information systems serving the same purpose"). However, this effort was abandoned because the data could not be transmitted in a way that met the international standard. During the same period, the region has also been investing in technology that is compatible with the international standard.

National role in monitoring pilot projects

As with many areas, the national role in Automatic Identification System research and pilot projects has not been strong. Since the 1997 report, Coast Guard headquarters has not played a strong co-ordinating role in the area as it has had limited knowledge of regional initiatives. Even though Coast Guard headquarters has a staff member who is an internationally recognized expert, the regions, for the most part, failed to include him in their projects.

In June 2002, the Coast Guard established a formal national project team for the implementation of the Automatic Identification System and other related technologies. The need for national co-ordination of Coast Guard activities followed the International Maritime Organization's decision to accelerate the implementation of this internationally.

Our concern

This case study illustrates the problems associated with pilot projects conducted on a regional basis without consideration of national policy or international standards. It also shows the need for national leadership in the evaluation of emerging technologies.

With limited funding available for research and capital projects, the Coast Guard should ensure that pilot projects are directed towards national priorities. It should also ensure that knowledge gained from pilot projects is considered in ongoing management decisions.

Key elements are not present to ensure accountability

2.54 The primary strategic objective of the activities we audited is to contribute to maritime safety and efficiency of navigation. We found that users of Canada's navigational support services generally consider them to support safe waterways and provide services that generally meet their navigational requirements. However, the Department has limited performance information to show how it contributes to these objectives.

Lack of national co-ordination for pilot projects

Background

The international marine community has been conducting ongoing research into integrating modern technologies such as global positioning, satellite communication, and advanced Very High Frequency radio communication. The term Automatic Identification System is now used to represent a new system that will provide mariners with real time, ship-to-ship and ship-to-shore digital navigation information.

Canada, largely through the Canadian Coast Guard, has conducted its own research into this system.

In 1994, Coast Guard headquarters, in consultation with industry, began its first study of it, including a 1996 pilot project on the St. Lawrence River.

The project final report, issued in August 1997, supported implementation of the system in Canadian waters. It also recommended that the Coast Guard and industry assess, on a national basis, the benefits and feasibility of its implementation. It concluded that there was a need to optimize the use of the existing marine communications equipment.

In addition, this project assessed the strengths and weaknesses of two competing radio technologies being considered internationally as a key part of the Automatic Identification System infrastructure. The study supported the use of the technology that was the strongest candidate for an international standard. Subsequently, this technology has been adopted as the international standard.

Pacific Region pilot project

In 1997, the Pacific Region, in collaboration with the local industry advisory group, began testing a system that was similar to the Automatic Identification System. However, it used radio technology different from the eventual international standard.

The pilot project built on technology that was being used to monitor tug activity on the West Coast. The Pacific Region and the local industry advisory group have been trying to broaden the applications that the system could support. However, despite the 1997 recommendations from the national study, the Pacific Region continued to provide support to this pilot project for a further two years.

Starting in 2000, the Pacific Region attempted to integrate the pilot project technology into its existing information and control system (case study, "Two information systems serving the same purpose"). However, this effort was abandoned because the data could not be transmitted in a way that met the international standard. During the same period, the region has also been investing in technology that is compatible with the international standard.

National role in monitoring pilot projects

As with many areas, the national role in Automatic Identification System research and pilot projects has not been strong. Since the 1997 report, Coast Guard headquarters has not played a strong co-ordinating role in the area as it has had limited knowledge of regional initiatives. Even though Coast Guard headquarters has a staff member who is an internationally recognized expert, the regions, for the most part, failed to include him in their projects.

In June 2002, the Coast Guard established a formal national project team for the implementation of the Automatic Identification System and other related technologies. The need for national co-ordination of Coast Guard activities followed the International Maritime Organization's decision to accelerate the implementation of this internationally.

Our concern

This case study illustrates the problems associated with pilot projects conducted on a regional basis without consideration of national policy or international standards. It also shows the need for national leadership in the evaluation of emerging technologies.

With limited funding available for research and capital projects, the Coast Guard should ensure that pilot projects are directed towards national priorities. It should also ensure that knowledge gained from pilot projects is considered in ongoing management decisions.

2.55 In its 2001 *Performance Report*, the Department states that its contribution to maritime safety will be demonstrated by

- reducing the number and severity of collisions and groundings in Canada's waterways,
- helping people in distress on Canadian waters, and
- preventing loss of life and damage to property.

2.56 In the same report, the Department also says that the achievement of its contribution to efficiency of navigation will be demonstrated by operational services and infrastructure that support commercially sustainable maritime industries. There is no further information on how these activities will affect the efficiency of navigation.

2.57 In the last year, the Canadian Coast Guard has prepared results-based management and accountability frameworks for each of its business and service lines. The frameworks are designed to help the Coast Guard plan, analyze, and report on its performance.

2.58 These frameworks show the link from the Coast Guard's activities to the ultimate impact on things like maritime safety. Exhibit 2.5 provides an example of the results chain included in the results-based management and accountability framework for the Office of Boating Safety.

2.59 The results-based management and accountability frameworks are an important first step in the Coast Guard's move to results and are a reasonable approach to managing for results and ensuring accountability. However, the following steps have yet to be completed:

- Establishing clear, measurable, concrete targets for the identified outputs and immediate outcomes for each framework.
- Identifying who is accountable for achieving targets and managing resources.

Exhibit 2.5 **Office of Boating Safety results chain**

Inputs	Activities	Outputs	Outcomes	Impacts
Resources (human, financial and assets)	Boating safety promotion, regulation, and partnerships	Boating safety guides and brochures, boating safety regulations, and partnerships	Public awareness of boating safety issues, behavioural change, compliance with regulations, increased enforcement of regulations, fewer recreational boating related fatalities and injuries, and public confidence in the Office of Boating Safety	Safe waterways and their users, clean environment, and support the Canadian economy

Source: Fisheries and Oceans Canada

2.55 In its 2001 *Performance Report*, the Department states that its contribution to maritime safety will be demonstrated by

- reducing the number and severity of collisions and groundings in Canada's waterways,
- helping people in distress on Canadian waters, and
- preventing loss of life and damage to property.

2.56 In the same report, the Department also says that the achievement of its contribution to efficiency of navigation will be demonstrated by operational services and infrastructure that support commercially sustainable maritime industries. There is no further information on how these activities will affect the efficiency of navigation.

2.57 In the last year, the Canadian Coast Guard has prepared results-based management and accountability frameworks for each of its business and service lines. The frameworks are designed to help the Coast Guard plan, analyze, and report on its performance.

2.58 These frameworks show the link from day to day activities to the ultimate impact on things like maritime safety. Exhibit 2.5 provides an example of the results chain included in the results-based management and accountability framework for the Office of Boating Safety.

2.59 The results-based management and accountability frameworks are an important first step in the Coast Guard's focus on results and are a reasonable approach to managing for results and ensuring accountability. However, the following steps have yet to be completed:

- Establishing clear, measurable, concrete targets for the identified outputs and immediate outcomes for each framework.
- Identifying who is accountable for achieving targets and managing resources.

Exhibit 2.5 Office of Boating Safety results chain

Inputs	Activities	Outputs	Outcomes	Impacts
Resources (human, financial and assets)	Boating safety promotion, regulation, and partnerships	Boating safety guides and brochures, boating safety regulations, and partnerships	Public awareness of boating safety issues, behavioural change, compliance with regulations, increased enforcement of regulations, fewer recreational boating related fatalities and injuries, and public confidence in the Office of Boating Safety	Safe waterways and their users, clean environment, and support the Canadian economy

Source: Fisheries and Oceans Canada

- Aligning budgeting and resource allocation with the frameworks.
- Developing or identifying sources of information to measure results.

2.60 A significant amount of work remains to make the frameworks fully operational. This will not be easy because the Coast Guard is not currently managed in the way specified by the frameworks.

2.61 The Department is facing many tough decisions about how to provide its services in the future, and managers are looking at different ways of delivering services. Ideally, they should be able to compare the current cost of providing a service with the cost of providing it in other ways. However, it is not always possible to obtain cost or activity information in sufficient detail to do these comparisons.

2.62 The Department's pilot performance reports in 1996 and 1997 provided data and analysis that were relevant to the Department's maritime safety and efficiency of navigation objectives even though the main focus was on activities and output information. For example, in 1996 the Department reported on the reliability of navigational aids, which is important to the success of this function. Currently, the Department collects the basic data needed to measure the reliability of navigational aids. However, it only reports it internally on an ad hoc basis.

2.63 The four departmental performance reports that followed the 1996 and 1997 pilot performance reports reflect a lack of direction in reporting performance for these activities. Although the programs have been stable, the nature of the indicators changes annually. The Department has steadily scaled back the data presented, and the quality of analysis has subsequently deteriorated.

2.64 Some of our concerns can be demonstrated by recreational boating safety, an area where Fisheries and Oceans Canada takes the lead. The Department's 2001 *Performance Report* uses charts and supporting analysis to show that it has decreased the number of recreational boating fatalities. It is plausible that the Department's activities may have contributed to reduced fatalities but there is no underlying information presented in the Report to demonstrate the link between this result and the Department's activities. The draft framework shown in Exhibit 2.5 is intended to show that link. Although the Department plays a lead role in this area, it is important to note that many other organizations also contribute to boating safety, including police forces, non-governmental organizations, boating associations, and manufacturers.

2.65 In addition, the 2001 *Performance Report* has charts that are presented in a way that exaggerate the changes in the number of fatalities and the number of licensed recreational boats from 1991 to 2000. Exhibit 2.6 compares the Department's presentation of this data with our own and suggests that the trends are not as dramatic as the Department reports.

2.66 The number of boating fatalities reported for 1999 and 2000 are based on projections rather than actual results. In our opinion, a projection based on past trends is not an accurate or appropriate method of reporting results.

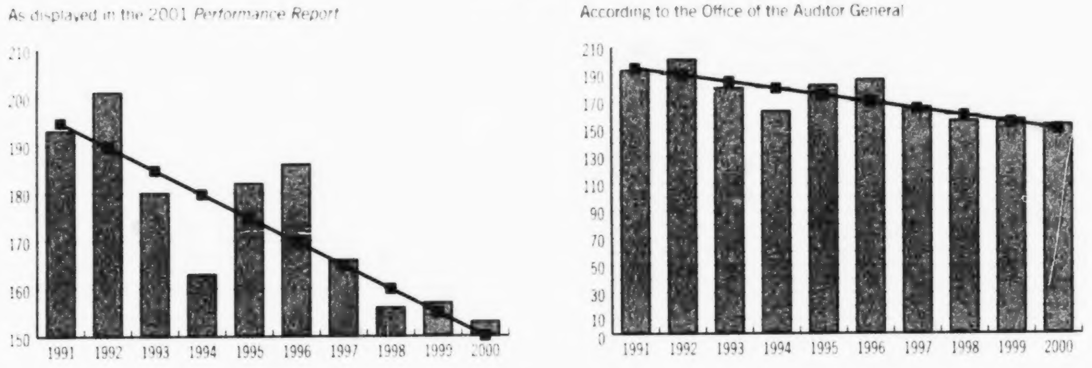
2.67 The Department has informed us that it intends to improve its public reporting in its 2002 *Performance Report*. It intends to focus on outcome information using the frameworks as its guide. The Department has also informed the Office that it will gradually increase the results information in subsequent performance reports as that information becomes available.

2.68 **Recommendation.** For its navigational support services and boating safety activities, Fisheries and Oceans Canada should do the following:

- complete the implementation of its results-based management and accountability frameworks;
- establish clear, measurable, concrete targets for the identified outputs and immediate outcomes for each framework;
- identify who is accountable for achieving targets and managing resources;
- align budgeting and resource allocation with the frameworks; and
- develop or identify sources of information to measure results.

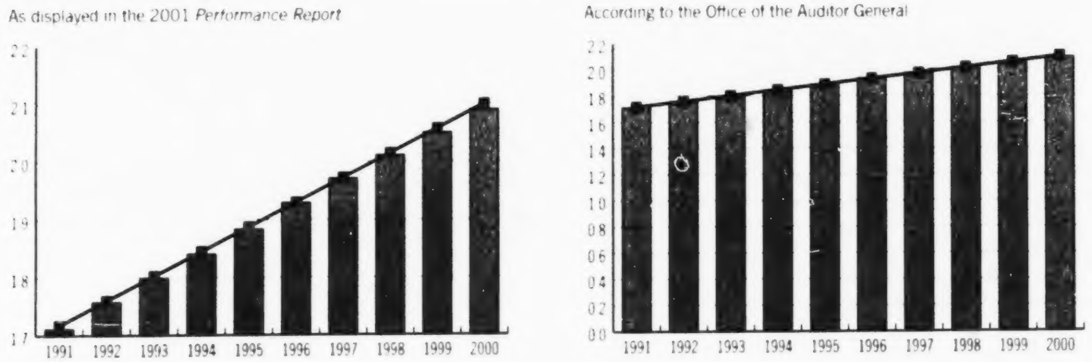
Exhibit 2.6 Presentation of licensing and fatality information

Boating fatalities


As displayed in the 2001 *Performance Report*

According to the Office of the Auditor General

Licensed recreational boats (millions)


As displayed in the 2001 *Performance Report*

According to the Office of the Auditor General

Source: Fisheries and Oceans Canada

Risks to safety and efficiency have not been regularly assessed

2.69 Recent international guidelines have placed an emphasis on the completion of regular risk assessments for major waterways. The Canadian Coast Guard played a major role in developing these guidelines. These assessments are a proactive means of determining the navigational support services that are needed to help avert marine accidents. As well, regular assessment of risk can contribute to more cost-effective management of the services provided by selecting the appropriate combination of services to help reduce risk.

2.70 The Coast Guard has developed a draft risk management policy and framework to ensure that there is a more systematic approach to risk management decision making. The draft policy and framework are consistent with the international guidelines.

2.71 The Coast Guard has not yet conducted comprehensive risk analyses for any Canadian waterway. Decisions to change levels of service are based on informal risk assessments. This means that the Coast Guard cannot determine the most appropriate combination of navigational support services that are needed for a particular waterway.

2.72 The development of draft guidance on risk management is an important step in modernizing the Coast Guard's approach to its preventive responsibilities. The challenge is to put the draft guidance into actual practice.

2.73 **Recommendation.** The Canadian Coast Guard should complete and implement its draft guidance on risk management.

Service delivery is not integrated

2.74 The Department's separate business lines deliver its navigational support services to external users. Internal Coast Guard units, such as Integrated Technical Services and Fleet Management, provide important support services to the business lines, including those that deliver the navigational support services.

2.75 We found that these business lines and shared services do not operate as an integrated business process to deliver the specific expected outcomes. Each has separate planning processes and, for the most part, has not considered the implications of activities conducted in the other business or service lines. Agreements have not yet been completed between the business lines and shared services to set out roles, responsibilities, and deliverables.

2.76 The Coast Guard has initiated a business performance management process to integrate strategic, business and long-term capital planning, resource allocation, and performance measurement. Management decision-making will be aligned with the strategic objectives and will focus on achieving the desired results. We support the intent of this initiative; however, it was not sufficiently advanced for us to audit.

2.77 **Recommendation.** Fisheries and Oceans Canada should develop and implement strategies to modernize and integrate the delivery of its navigational support services to meet user needs.

Outdated legislation is used for unintended purposes

2.78 Under the *Navigable Waters Protection Act*, the Department is responsible for protecting the public right to navigation; however, these efforts have been seriously hampered by outdated legislation.

2.79 The *Navigable Waters Protection Act* became law over 120 years ago. It was originally intended to protect marine navigation routes by controlling the logging industry and the construction of bridges, dams, and other obstructions. Today, the operating environment has changed significantly and the program's clients and stakeholders have grown in number and variety with the introduction of new waterway uses. The Act has become a way for the general public, municipalities, environmentalists, and boaters to resolve conflicts with other waterway users. However, most of these conflicts are not about navigation.

2.80 The Act has frequently been used in the approval of aquaculture sites. However, it cannot deal with the rapidly expanding industry that is increasingly competing with traditional waterway users. The number of aquaculture permit applications per year has grown from 172 in 1997 to 354 in 2001. Many of the issues surrounding these sites are more related to competing social, economic, and environmental interests rather than navigation. The *Navigable Waters Protection Act* is one of the few ways that interested parties can make their concerns known and trigger a review under the *Canadian Environmental Assessment Act*. There is a significant backlog of applications.

2.81 The Department has observed widespread non-compliance with aquaculture permit conditions, and, in some cases, sites have been established before permits were issued. The Department devotes a small number of resources to ensure that applicants meet the specified conditions after approval. It relies primarily on complaints from other users to ensure compliance.

2.82 Fisheries and Oceans Canada's 1997–98 *Report on Plans and Priorities* identified the need to amend the *Navigable Waters Protection Act*. The Department is aware of the problems created by the Act and it has recently begun a policy review of the legislation.

Activities undertaken that do not support safety and efficiency

2.83 Despite the Department's ongoing commitment to reducing costs in its operations, we found that it conducts activities that do not support its maritime safety and efficiency of navigation objectives. One example of this is staffed light stations.

2.84 The Canadian Coast Guard began its program to automate, remove staff, and remotely monitor light stations in 1970. However, it still maintains 51 staffed light stations. Because of a 1998 government decision, the

Department staffs 50 light stations in the Newfoundland and Pacific regions, largely for heritage reasons. The other remaining light station, in the Maritimes Region, is staffed for sovereignty purposes.

2.85 In December 1998, the Treasury Board approved $47.6 million in operating funds and $24.3 million in capital funds over five years (1998–99 to 2002–03) to continue staffing light stations in the Newfoundland and Pacific regions. In addition, ongoing operating funding of $12.9 million annually was approved for years after 2002–03. The Treasury Board requested that the Department review the decision to maintain staffing at the light stations after five years.

2.86 The Department does not track or monitor the costs of maintaining and operating staffed light stations and therefore it does not know whether it has been given appropriate funding. Without this information, it will be difficult for the Department to meet the Treasury Board review requirements.

2.87 The Department is in a difficult position. What is the role of light keepers given the largely automated state of the existing staffed light stations? How can the light keepers play an effective role in supporting heritage objectives given the remoteness of many of the staffed light stations? We also noted that the Coast Guard maintains more than the minimum number of staff needed at some light stations. It is unclear how staffed light stations serve a heritage objective.

2.88 It is now accepted that staffed light stations are not necessary for maritime safety and navigational efficiency. A 1998 Canadian Coast Guard study found that most industrialized countries were removing staff from light stations, and

- the United States had removed staff from 474 of 475 light stations since 1990,
- England had removed staff from 68 of 72 light stations,
- Ireland had removed staff from all of its 80 light stations, and
- Australia had removed staff from 102 of its 104 light stations.

2.89 There is no consistent approach within the Department to determine and maintain the heritage value of Canada's staffed and automated light stations. We observed that the Maritimes Region is actively seeking partners to assume responsibility for light stations that are no longer needed by the Coast Guard. This is a balanced approach to maintaining our heritage.

2.90 **Recommendation.** Fisheries and Oceans Canada should develop and implement an overall strategy for the future of its light stations considering maritime safety and heritage objectives.

There is limited focus on a core mandate

2.91 Recreational boating is a popular activity, with as many as 2.7 million boats and 8 million boaters in Canada. The Office of Boating Safety, as part of the Canadian Coast Guard, implements the Department's responsibilities for recreational boating safety. Since April 1999, regulations under the *Canada*

Shipping Act have been introduced to place restrictions on boat operators, require mandatory operator competency for powerboats, define minimum safety equipment, and introduce other safety precautions.

2.92 Recreational boater competence is an important safety concern with more than 150 boating fatalities annually. The Office of Boating Safety encourages safe practices and responsible boating through education and certification of operator competency.

2.93 The Office of Boating Safety has base funding of $3 million; however, its actual expenditures over the last three years have ranged from $7 million to $10 million. Reallocating funding from within the Department's and Coast Guard's budgets have covered the difference. Even with the additional funds, the Office of Boating Safety does not have the ability to ensure compliance with the new regulations.

2.94 The Office of Boating Safety relies almost exclusively on third parties such as police forces, the Coast Guard auxiliary, the private sector, and non-governmental organizations for educating boaters and for enforcement and compliance. However, it has not determined that relying on third parties has been successful.

2.95 There are a number of problems associated with the boater competency certification that is delivered by third parties. The Competency of Operators of Pleasure Craft Regulations, introduced in 1999, require all recreational boaters operating a powered recreational vessel less than four metres in length (including personal watercraft) to carry proof of operator competency by 15 September 2002. The Office of Boating Safety estimates that 75 percent, or about 1.6 million licensed recreational boats fall into this category.

2.96 By the end of 2001, only 308,000 operator competency cards had been issued. The Office of Boating Safety has no record of persons who have obtained such a card, it does not know how many more boaters must be certified, and it will be unable to determine the extent of compliance with the competency requirements.

2.97 The Department is responsible for construction standards for small recreational vessels. The Office of Boating Safety relies on self-reporting from manufacturers that their vessels conform to standards; although it can do inspections, it rarely does this because of a lack of resources. From time to time, it does undertake investigations in response to complaints. There are risks associated with the Office of Boating Safety's limited ability to ensure that construction standards are met (case study, "Difficulty in ensuring compliance with construction standards for pleasure boats").

2.98 **Recommendation.** Fisheries and Oceans Canada should gather and monitor information on boating safety to assess the adequacy of third party delivery, determine the extent of compliance with regulations, and review the adequacy of the resources provided to this program.

Difficulty in ensuring compliance with construction standards for pleasure boats

Background

The Minister of Fisheries and Oceans is responsible, under the *Canada Shipping Act*, for all matters related to the safety and licensing of pleasure craft. Regulations under the Act require that pleasure craft meet construction standards. Among others, these construction standards set out the specifications for flotation material used in pleasure craft up to six meters in length. Flotation material helps keep vessels afloat in case of an accident.

Problems with foam flotation

In 2000, the Office of Boating Safety received a complaint about the construction of aluminum boats by a specific builder. After an initial investigation, the Office of Boating Safety focussed its review on the various types of foam flotation in the marine industry.

Builders are responsible for ensuring that vessels meet the construction standards. Many builders indicated that the foam material used was imported and met comparable specifications in the United States. However, the Office of Boating Safety found that two of the eight foam suppliers contacted could not show that their product met United States standards. The review also found that most builders and suppliers contacted were unaware of the Canadian standards. None of the eight suppliers of foam flotation contacted were able to demonstrate that their product complied with Canadian construction standards.

The review noted that concerns were raised by many knowledgeable parties that, over time, foam flotation in small vessels becomes saturated with water. This would limit the buoyancy of such vessels in case of an accident.

Since the review was completed in early 2001, the supplier of the foam to the builder initially investigated and two other suppliers have demonstrated that their product does, in fact, meet the Canadian construction standards. However, the Office of Boating Safety has not yet received information from the remaining suppliers demonstrating that their products meet Canadian standards.

The Office of Boating Safety has limited capacity to deal with issues related to construction standards. There are approximately 300 builders of small boats in Canada and only three qualified inspectors within the Office of Boating Safety to deal with construction standards.

Our concern

We are concerned about the limited capacity of the Office of Boating Safety to ensure that pleasure boats meet Canadian construction standards.

The Marine Services Fees have created a difficult relationship with industry

2.99 The Program Review and 1995 National Marine Policy set the context for the Marine Services Fees charged to the commercial shipping industry for both marine navigational services and icebreaking. The fees are designed to recover a portion of the cost of certain navigational support services that are provided by the Canadian Coast Guard.

2.100 The fees for marine navigational services were put in place in 1996 but was revised in 1998 after consultations with industry. The icebreaking fee was implemented in 1998. The revised fee structure was designed to recover $34.6 million annually, including the $26.7 million for marine navigation services, $6.7 million for icebreaking services, and $1.2 million in associated administrative costs.

2.101 The revenue from the Marine Services Fees has not been sufficient to meet the $34.6 million annual revenue target. This has led to shortfalls in the funding available for Coast Guard programs because its funding was reduced on the basis that the $34.6 million annual revenue target would be met. Between 1996–97 and 2001–02, the Coast Guard has absorbed $25.4 million in funding shortfalls within ongoing program activities.

2.102 The introduction of the Marine Services Fees has also had positive consequences. There has been a more realistic assessment of the number and

Difficulty in ensuring compliance with construction standards for pleasure boats

Background

The Minister of Fisheries and Oceans is responsible, under the *Canada Shipping Act*, for all matters related to the safety and licensing of pleasure craft. Regulations under the Act require that pleasure craft meet construction standards. Among others, these construction standards set out the specifications for flotation material used in pleasure craft up to six meters in length. Flotation material helps keep vessels afloat in case of an accident.

Problems with foam flotation

In 2000, the Office of Boating Safety received a complaint about the construction of aluminum boats by a specific builder. After an initial investigation, the Office of Boating Safety focussed its review on the various types of foam flotation in the marine industry.

Builders are responsible for ensuring that vessels meet the construction standards. Many builders indicated that the foam material used was imported and met comparable specifications in the United States. However, the Office of Boating Safety found that two of the eight foam suppliers contacted could not show that their product met United States standards. The review also found that most builders and suppliers contacted were unaware of the Canadian standards. None of the eight suppliers of foam flotation contacted were able to demonstrate that their product complied with Canadian construction standards.

The review noted that concerns were raised by many knowledgeable parties that, over time, foam flotation in small vessels becomes saturated with water. This would limit the buoyancy of such vessels in case of an accident.

Since the review was completed in early 2001, the supplier of the foam to the builder initially investigated and two other suppliers have demonstrated that their product does, in fact, meet the Canadian construction standards. However, the Office of Boating Safety has not yet received information from the remaining suppliers demonstrating that their products meet Canadian standards.

The Office of Boating Safety has limited capacity to deal with issues related to construction standards. There are approximately 300 builders of small boats in Canada and only three qualified inspectors within the Office of Boating Safety to deal with construction standards.

Our concern

We are concerned about the limited capacity of the Office of Boating Safety to ensure that pleasure boats meet Canadian construction standards.

The Marine Services Fees have created a difficult relationship with industry

2.99 The Program Review and 1995 National Marine Policy set the objective for the Marine Services Fees charged to the commercial shipping industry for both marine navigational services and icebreaking. The fees are designed to recover a portion of the cost of certain navigation support services that are provided by the Canadian Coast Guard.

2.100 The fees for marine navigation services were put in place in 1996. It was revised in 1998 after consultations with industry. The icebreaking fee was implemented in 1998. The revised fee structure was designed to recover $34.6 million annually, including the $26.7 million for marine navigation services, $6.7 million for icebreaking services, and $1.2 million for associated administrative costs.

2.101 The revenue from the Marine Services Fees has not been sufficient to meet the $34.6 million annual revenue target. This has led to shortfalls in the funding available for Coast Guard programs because its funding was reduced on the basis that the $34.6 million annual revenue target would be met. Between 1996–97 and 2001–02, the Coast Guard has absorbed $25.4 million in funding shortfalls within ongoing program activities.

2.102 The introduction of the Marine Services Fees has also had positive consequences. There has been a more realistic assessment of the number and types of navigational aids that are required to support commercial shipping. The introduction of the fees has also motivated industry to become more actively involved in determining service levels.

2.103 Industry believes that the Marine Services Fees should be eliminated or, at least, minimized. Industry and the Coast Guard have collaborated on many issues over the last four years. However, industry still seems to believe that the Coast Guard cannot change enough to answer its concerns.

2.104 Most discussions between industry and senior Coast Guard officials are now dominated by industry concern for stability in the fee structure and a desire for the fees to be eliminated or decreased over time. The marine industry faces many challenges, including increased competition from other modes of transportation. While there are potential opportunities for the industry and the Coast Guard to work together to streamline existing navigational support services, the focus on the Marine Services Fees debate makes it difficult for them to co-operate.

Our Office has said this before

2.105 Chapter 13 of our 1983 Annual Report describes the results of an audit of Transport Canada's Marine Transportation Program. Many of the areas covered in this audit were also in our 1983 audit. While there have been many new technologies and services introduced since 1983, we are concerned about the similarity of today's management issues to concerns we expressed almost 20 years ago. The Appendix summarizes the key relevant observations from 1983.

Conclusion

2.106 Fisheries and Oceans Canada has a clear mandate to support safe and efficient marine navigation. Its roles and responsibilities within Canada's marine transportation system are well defined. There is a need to modernize and improve delivery of the Department's preventive responsibilities. The Department has recognized this need. It has various plans and initiatives to implement change. However, there are significant barriers to change, particularly

- failure to ensure that there is one national program,
- regional operations that are not held accountable for implementing national policies and meeting international obligations,
- key elements to ensure accountability are not present,
- inadequate integration of navigational support services,
- provision of a service that does not contribute to the mandate for safety and efficiency, and
- the *Navigable Waters Protection Act* is outdated and being used for unintended purposes.

2.107 The Department has not cost-effectively managed the functions we examined and changes have to be made to ensure the system meets user needs in the future.

2.108 **We are concerned that the Department has not responded to issues that have been confronting the organization for many years. We believe that the Department must develop and implement an action plan to respond to the fundamental issues in this report.**

Department's response. Fisheries and Oceans Canada accepts the Auditor General's findings and is committed to finding solutions. Although the Auditor General concludes that users of Canada's navigational support services generally consider that these services contribute to the delivery of safe and efficient waterways, the Chapter describes accurately the challenges and barriers that the Department faces in contributing to the delivery of safe and efficient waterways.

The Department recognizes many of the findings raised by the Auditor General and has started numerous initiatives in response to these findings. The legislative reform (such as regulations under the new *Canada Shipping Act*), development of results-based management and accountability frameworks, and Coast Guard Headquarters Renewal Initiatives are examples of such initiatives. The Department believes that the completion of these initiatives and the development of those described in response to the recommendations will provide the required framework to provide navigational support services in a more cost-effective manner.

The following paragraphs describe the action that the Department will take in response to the audit recommendations.

- Recommendation 2.53—The Canadian Coast Guard's Headquarters Renewal Initiative is now complete and Headquarters staff, in co-operation with their regional colleagues, will develop a plan to update all national policies and standards. Finally, the Coast Guard will develop a quality assurance function to regularly monitor the implementation of the policies, standards, and levels of services. These measures will be implemented over many years.
- Recommendation 2.68—The Coast Guard began the development of results-based management and accountability frameworks and will continue these efforts in 2003–04. Once fully developed, the Coast Guard plans to implement these frameworks on a national basis.
- Recommendation 2.73—The Coast Guard is developing a risk management policy framework and management tools on risk management in order to integrate risk management principles and concepts in the decisions making process. The Coast Guard is also in the process of developing risk assessment tools. These tools will be used to assess risks in selected waterways starting in 2003–04.
- Recommendation 2.77—As noted in the chapter, the Department has started a number of initiatives to modernize the delivery of its navigation support services and other Coast Guard services. The implementation of comprehensive risk-based methodology and completion of the business planning processes will ensure greater integration in service delivery. More detailed action plans with implementation dates will be completed.

- Recommendation 2.90—The Department will complete the review of the staffed light stations by 2003. In addition, the Department will continue the assessment of its entire light station portfolio and define specific measures for the disposal or rationalization of light stations that are not required for operational reasons.
- Recommendation 2.98—The Coast Guard will respond to this recommendation through the continuing development of its results-based management and accountability frameworks.

About the Audit

Objective

The objective of the audit was to assess the extent to which Fisheries and Oceans Canada's management of its preventive activities support its commitment to provide for safe and efficient waterways in a cost-effective manner.

Scope and approach

The audit focussed on the preventive aspects of the Department's activities supporting its commitment to provide for safe and efficient waterways. Broadly speaking, these activities relate to the navigational support services that fall within the Canadian Coast Guard's Marine Navigation Services (aids to navigation, channel maintenance, and navigable waters protection), and Marine Communications and Traffic Services business lines. The Canadian Hydrographic Service provides navigational charts, publications, digital and other navigational information. In addition, we examined the Office of Boating Safety's preventive responsibilities.

We did not examine the Department's search and rescue and environmental response activities in this audit. In addition, we did not examine the support for fishing harbours. Although icebreaking is an important part of the navigational support services, it has been excluded as it was largely covered in our 2000 Report, Chapter 31, Fleet Management.

We also did not examine maritime security in this audit. However, certain navigational support systems were examined because they play a role in supporting those departments and agencies that are responsible for maritime security.

Criteria

Given the above audit objective and scope, we expected the Department to do the following:

- Clearly define its mandate, including role and responsibilities, within Canada's marine transportation system, as it relates to supporting safe and efficient navigation in Canadian waterways.
- Specify the nature of activities and level of services necessary to fulfill its mandate, meet user needs, and ensure compliance with Canada's laws and international agreements.
- Establish expected outcomes for its key result commitment to safe and efficient waterways and report to Parliament on its results, including financial performance.
- Develop and implement strategies to manage its navigational support services and recreational boating safety responsibilities in a cost-effective manner.

Audit team

Assistant Auditor General: Ronald C. Thompson
Principal: John O'Brien
Directors: Gerry Chu and Kevin Potter

Glenn Doucette
Don MacNeill
Sandy Manels
Erin Windatt

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Appendix Key findings from our 1983 Report on the Canadian Coast Guard's preventive responsibilities

Management activity	Key findings
Determining levels of service	The Canadian Coast Guard has not adequately analyzed the needs of mariners and has not defined the extent and quality of services provided. As a result, the ability to plan and control Coast Guard activities is weakened.
Improved program efficiency	Cost savings in the range of $10 million to $20 million annually are possible if the Coast Guard implements the following improvements in its activities: • completes the lighthouse automation program started in 1970 but which has, in essence, been put on hold; • revises its standards for checking and maintaining buoys; • reassesses the continuing need and specific equipment requirements for some of its Vessel Traffic Service systems; and • increases the automation and consolidation of the Coast Guard radio stations.
Weaknesses in planning, operations, and the information used to manage marine programs	There is insufficient overall analysis of need or assessment of which port would benefit most from Vessel Traffic Service systems. These systems were established in response to major marine incidents. The Coast Guard has not adequately reviewed the continuing need for each of its 272 lightstations, although, at an average annual operating cost of $125,000 each, they are the most expensive aids it operates. The Coast Guard has not assessed the impact of adopting improved electronic aids such as radar, Loran-C, and racons on the more traditional aids such as lightstations or radio beacons.
Performance measurement	In many areas such as buoys and lightstations, the Department lacks adequate cost information to allow managers to decide whether a given type of aid or a given district is being operated in the most efficient manner.
Risk assessment	Marine safety is best achieved by following a comprehensive and co-ordinated program based on a systematic assessment of risk, and by carrying out an appropriate mix of activities, within resource limits, to minimize risk. Although the Department collects data on the marine incidents it investigates, it does not systematically analyse all these data to monitor relative levels of marine safety by type of traffic and degree of risk.

Report of the Auditor General of Canada to the House of Commons—December 2002

Main Table of Contents

Matters of Special Importance—2002
Foreword and Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada—Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada—Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

Appendices

2002

Report of the
Auditor General of Canada
to the House of Commons

DECEMBER

Chapter 3
Special Import Measures Act:
Protecting Against Dumped or
Subsidized Imports

Office of the Auditor General of Canada

The December 2002 Report of the Auditor General of Canada comprises 11 chapters, Matters of Special Importance—2002, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

Ce document est également disponible en français.

© Minister of Public Works and Government Services Canada 2002
Cat. No. FA1-2002/2-11E
ISBN 0-662-33109-5

Chapter

3

Special Import Measures Act: Protecting Against Dumped or Subsidized Imports

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

Table of Contents

Main Points 1

Introduction 3

The SIMA process 5
Parliamentary review 7
Focus of the audit 7

Observations and Recommendations 8

Implementing the subcommittees' recommendations 8

In most cases, the CCRA and the CITT have modified their management framework as required 8
Further work needed to fully implement three key recommendations 10

Access to confidential information 10

The CCRA has denied complainants access to confidential information 11
Users generally satisfied confidential information will be protected but still have concerns 11

Splitting responsibilities between the CCRA and the CITT 15

CCRA officers need additional training and guidance 16
The CCRA is in the initial phase of examining expiry review procedures 16
Complaints and expiry reviews are becoming more expensive and time-consuming 17

Access for small and medium-sized businesses 18

Small and medium-sized Canadian producers face several barriers 18
The CCRA plans and initiatives for small and medium-sized producers have stalled 19

Conclusion 21

About the Audit 22

Appendix

The SIMA findings and orders in force as of 31 March 2002 23

Special Import Measures Act: Protecting Against Dumped or Subsidized Imports

Main Points

3.1 In 1996 two parliamentary subcommittees conducted a significant review of the *Special Import Measures Act* (SIMA) and issued 10 recommendations to make it more efficient and responsive to Canada's economic needs. Our audit found that the government accepted all the recommendations except for part of two, and changes were made to the applicable legislation and regulations effective 15 April 2000.

3.2 We found that the Canada Customs and Revenue Agency (CCRA) and the Canadian International Trade Tribunal (CITT) have put in place the support and management processes needed to implement most of the recommendations. However, more work is needed to fully implement three key recommendations and address significant concerns in the following areas:

- access to confidential information;
- splitting responsibilities between the CCRA and the CITT; and
- access to the complaints process for small and medium-sized Canadian producers.

3.3 Issues related to granting counsel access to confidential information about the users' business was the greatest concern. Users, such as complainants, are generally satisfied that confidential information provided to domestic counsel will remain protected. However, they are greatly concerned about giving the confidential information to foreign counsel and expert witnesses. Furthermore, they are not convinced that the penalties in place for breach of confidentiality could be enforced. Participants in the SIMA process need to be assured of confidentiality in order for the system to have integrity. We also noted inconsistent requirements for access to confidential information by the Agency and the Tribunal. The CCRA is being challenged in the courts on its interpretation of who is entitled to have access to confidential information in particular circumstances.

3.4 In recent years there has been an increasingly heavy financial, time, and information burden associated with participating in the SIMA process. As a result, the process has become more difficult for users and the barriers to access may now be greater than they were before. Innovative ways need to be found to reduce these barriers wherever possible.

3.5 The subcommittees recommended that the CCRA take concrete measures to ensure fair and equal access to the SIMA process for small and medium-sized Canadian producers. The Agency produced a plan in response to the recommendation, but implementation has stalled since 1998.

Background and other observations

3.6 The SIMA provides a trade remedy system that protects Canadian producers from injury caused by dumped or subsidized goods imported into Canada. Trade remedy actions have had a relatively minor impact on the Canadian economy; by value, they affect about 1 percent of goods imported into Canada. In industries where they do apply, however, they have a substantial impact on Canadian producers and industries that use the imported goods. These include the steel and farming sectors, where dumped and subsidized goods have been found to cause serious financial difficulties. In one case, Canadian producers saw their gross margin of a specific steel product decline from 23 percent to 7 percent in six months. Their net income before taxes dropped $92 million, from $61 million to a loss of $31 million.

3.7 In 1996, the SIMA was reviewed by two House of Commons subcommittees: the Subcommittee on the Review of the *Special Import Measures Act* of the Standing Committee on Finance, and the Subcommittee on Trade Disputes of the Standing Committee on Foreign Affairs and International Trade. After many hearings, the subcommittees concluded that the SIMA was working well overall, and that it continued to be relevant to the competitive needs of the Canadian business community. At the same time, the subcommittees made 16 recommendations intended to make the Act more efficient and responsive to Canada's economic needs. Changes resulting from these recommendations have direct implications for SIMA stakeholders and users, including complainants, importers, exporters, trade experts, lawyers, and trade associations.

3.8 The subcommittees recommended that some administrative responsibilities be split between the CCRA and the CITT. We found that CCRA officers need additional training and guidance to meet their new responsibilities and that the Agency and the Tribunal need to work together to resolve inefficiencies that still exist.

The Agency and the Tribunal have responded. The Canada Customs and Revenue Agency and the Canadian International Trade Tribunal have generally agreed with our recommendations. Their responses, including the action that they are taking or intend to take to address the recommendations, are set out in the chapter. Action includes updating the guidelines on protection of confidential information, exploring options to provide more assistance to small and medium-sized Canadian producers, and consulting with each other to reduce administrative inefficiencies.

Introduction

3.9 Canada is a trading nation. In 2001 Canadians imported $343 billion worth of goods. Exports were worth $422 billion, or almost 37 percent of our country's gross domestic product. Usually trade benefits Canadians, but sometimes foreign exporters to Canada use trading practices that injure Canadian producers. To seek relief, the producers can turn to the *Special Import Measures Act* (SIMA), one of Canada's main trade remedy laws.

3.10 The Canadian trade remedy system, like that in other countries, is based on rules set down in the original text of the 1947 General Agreement on Tariffs and Trade (GATT). The rules have been refined extensively over the years through successive multilateral negotiations—most recently the Uruguay Round negotiations, which concluded with the 1994 World Trade Organization (WTO) agreements. For trade remedies there are three main agreements: the Anti-Dumping Agreement, the Agreement on Subsidies and Countervailing Measures, and the Agreement on Safeguards. These provide the basis for domestic trade legislation, and the international legal framework that defines how member countries determine whether injurious dumping or subsidizing exists, and what they can do about it.

3.11 Dumping is the sale abroad of goods at prices lower than their normal value—usually the selling price of the goods, or comparable goods, in the exporter's country. Subsidizing is the provision of financial assistance by a government to an exporter based within that government's jurisdiction. This subsidization lowers the selling price of goods abroad.

3.12 When a Canadian producer or industry making the same or similar goods can show that it has been injured by dumped or subsidized imported goods, the SIMA allows the government to impose duties on the goods imported into Canada. Forms of injury include reduced prices in the Canadian marketplace, lost sales or market share, decreased profits, or a drop in employment levels for the Canadian industry. Canada can offset the dumping of imported goods by applying anti-dumping duties on those goods when they are imported into Canada; it can offset the subsidizing of imported goods by applying countervailing duties.

3.13 Anti-dumping and countervailing duties are exceptions to liberalized trade. They are applied in specific situations on the basis of the findings of a detailed investigation. They give the affected domestic industry some protection from imports dumped in Canada or subsidized by a foreign government. At the same time they lead to higher prices for the imported goods, and the greater expense affects users of those goods, both consumers and downstream industries. The SIMA is designed to provide a balance between two differing interests: Canadian producers or industries that need protection from injurious dumped or subsidized imports, and Canadian businesses that need access to imports.

3.14 [illegible]

3.15 [illegible]

Exhibit 3.1 Examples of the negative effects on Canadian producers of the dumping of certain imported goods

Sector	Effects of dumping*
Certain products in the medical sector	The Canadian producer suffered a decline [illegible] sales of over $2 [illegible]. The [illegible] margin of one of these products [illegible] percent over two years [illegible]
Certain products in the steel sector	For one of the steel products, [illegible] suffered a cumulative [illegible] 15 percent [illegible] sales [illegible] prices of this product. The reduction [illegible] loss in operating income of over $44 [illegible] For another steel product, the producers' gross margin declined from 24 percent to 7 percent [illegible]. Their net income before taxes dropped $[illegible] from $61 million to a loss of $31 million.
Certain products in the retail sector	The Canadian market grew but the share of domestic market by Canadian producers was declining. Gross margins of the Canadian producer for refrigerators declined by 33 percent and 28 percent in two successive years. Similar weak market and financial performance also occurred for dishwashers and dryers.
Certain products in the farming sector	The financial performance of the domestic garlic growers collapsed. In 1998, the garlic growers (small and medium-sized producers) were profitable with gross farm returns of about $170,000. In 1999, the domestic growers lost $348,000. In 2000, their loss increased to over $1 million. Approximately 70 percent of garlic farming in Canada was steadily increasing from 300 acres to almost 900 acres between 1997 and 1999. However, it dropped by about one third in 2000.

3.14 From the perspective of the Canadian economy as a whole, trade remedy actions have had a relatively minor impact; by value, they affect about 1 percent of goods imported into Canada. In industries where they apply, however, they have a substantial impact. Examples are the steel and farming sectors, where dumped and subsidized goods have been found to have caused serious financial difficulties. Exhibit 3.1 provides examples of the negative effects on Canadian producers of the dumping of certain imported goods. The Appendix lists the SIMA findings and orders in force as of 31 March 2002.

3.15 The *Special Import* Measures Act was passed in 1984 to consolidate and modernize Canada's trade remedy laws. It replaced the *Anti-dumping* Act and certain provisions in the Customs Tariff concerning countervail. Substantial

Exhibit 3.1 Examples of the negative effects on Canadian producers of the dumping of certain imported goods

Sector	Effects of dumping*
Certain products in the medical sector	The Canadian producer suffered a decline in domestic sales of over $2 million in nine months. The gross margin of one of these products fell by more than 50 percent over two years, resulting in financial losses.
Certain products in the steel sector	For one of the steel products, domestic producers suffered a cumulative decline of over 16 percent in net sales revenue over two years, mainly due to reduced sales volume and significantly lower average selling prices of this product. This reduction contributed to a loss in operating income of over $44 million. For another steel product, the producers' gross margin declined from 23 percent to 7 percent in six months. Their net income before taxes dropped $92 million from $61 million to a loss of $31 million.
Certain products in the retail sector	The Canadian market grew but the share of domestic market by Canadian producers was declining. Gross margins of the Canadian producer for refrigerators declined by 33 percent and 25 percent in two successive years. Similar weak market and financial performance also occurred for dishwashers and dryers.
Certain products in the farming sector	The financial performance of the domestic garlic growers collapsed. In 1998, the garlic growers (small and medium-sized producers) were profitable with gross farm returns of about $170,000. In 1999, the domestic growers lost $348,000. In 2000, their loss increased to over $1 million. Approximately 70 percent of garlic farming in Canada was steadily increasing from 300 acres to almost 900 acres between 1997 and 1999. However, it dropped by about one third in 2000.

* Effects reported in the Statement of Reasons for the SIMA findings

Source: Canadian International Trade Tribunal changes were made to the Act in 1994 to implement Canada's international obligations resulting from the Uruguay Round negotiations. Further changes were made in 1999 in response to a 1996 parliamentary review.

The SIMA process

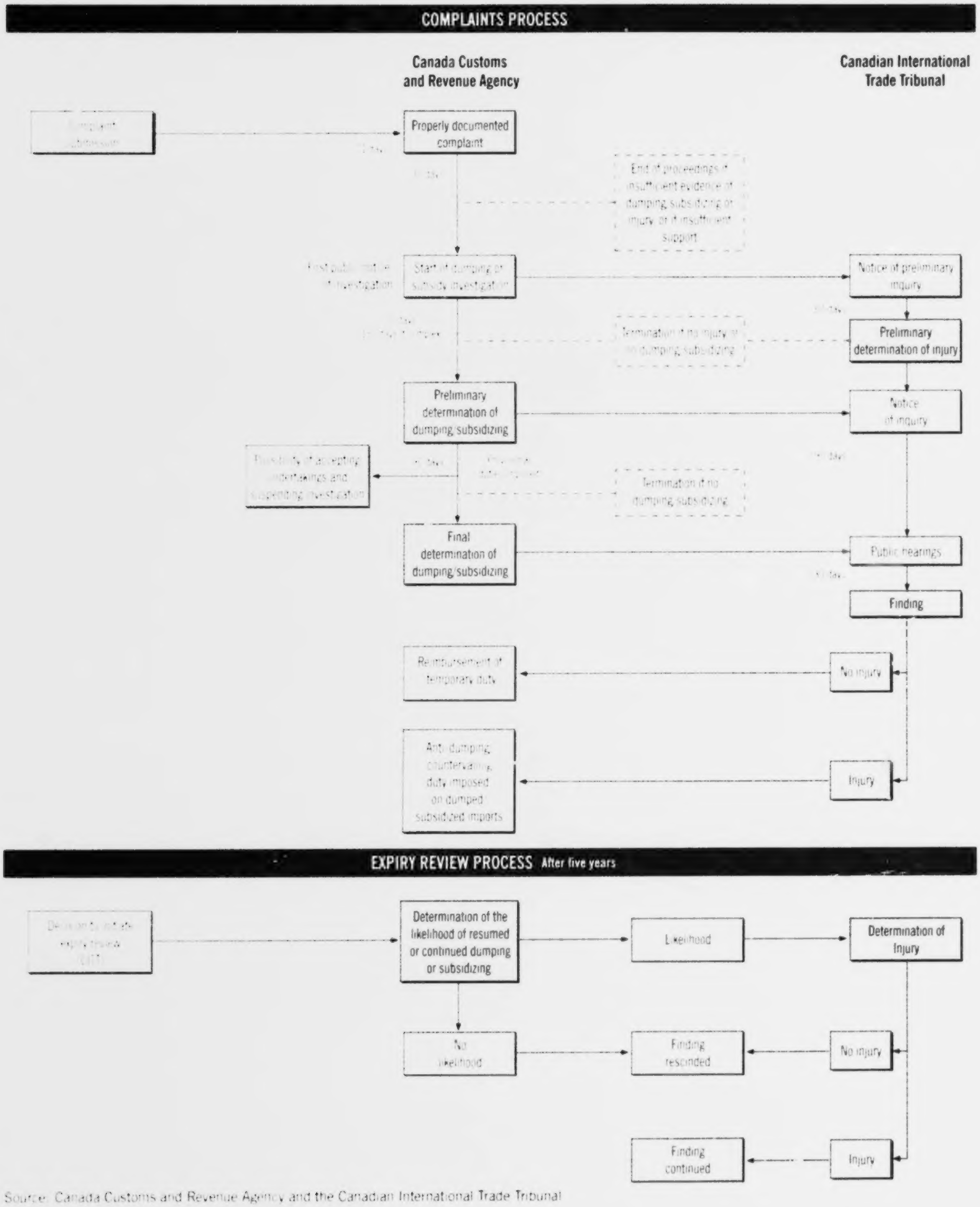
3.16 Three government organizations are involved in administering the SIMA. The Department of Finance is responsible for policy and legislative aspects. The Canada Customs and Revenue Agency (CCRA) is responsible for initiating investigations, determining whether dumping or subsidizing has occurred, and collecting anti-dumping or countervailing duties. The Canadian International Trade Tribunal (CITT), an independent quasi-judicial body, is responsible for determining whether Canadian producers have been or are threatened to be injured as a result of dumping or subsidizing.

3.17 The Act defines the stages in the SIMA process and the related time limits (Exhibit 3.2). With few exceptions, the process starts when a domestic producer files a complaint with the CCRA. If the Agency determines that the complaint is based on reasonable evidence of injurious dumping or subsidizing and is supported by producers representing at least 25 percent of the total Canadian production of the goods in question, it initiates the investigation. The CCRA and the CITT carry out simultaneous investigations, with the Agency focussing on dumping or subsidizing and the Tribunal focussing on injury. The participants in the process include the original complainant, other producers in the same industry, foreign exporters of the goods in question, foreign governments, and Canadian importers or purchasers of the goods. Most participants are represented by counsel during the investigation.

3.18 If the Agency determines that dumping or subsidizing has occurred and the Tribunal finds that material injury has been caused to the major proportion of total domestic production, or that there is a threat of injury, the Act mandates imposition of anti-dumping or countervailing duties. These are generally equal to the dumping margin (the difference between the price charged to Canadians and the normal value of the goods) or the level of subsidization, and are collected by the Agency when the goods are imported. The Minister of Finance may, on recommendation of the Tribunal, decide not to impose the full duty for public interest reasons. Exporters can eliminate anti-dumping duty liability by charging Canadians a price equal to the normal value; foreign governments can avoid countervailing duties by imposing an offsetting tax or other arrangement to negate the subsidy.

3.19 Anti-dumping and countervailing duty measures normally expire five years after the date of the CITT injury finding. If the Tribunal decides to initiate a review based on the submissions it receives, the Agency and the Tribunal conduct an expiry review to determine whether ending a measure would lead to renewed dumping or subsidization causing material injury to domestic producers. If they find that it would do so, the measure is extended for another five years.

Exhibit 3.2 ***Special Import Measures Act* process**


COMPLAINTS PROCESS
Canada Customs and Revenue Agency
Canadian International Trade Tribunal
Complaint submission
Properly documented complaint
End of proceedings if insufficient evidence of dumping/subsidizing or injury or if insufficient support
First public notice of investigation
Start of dumping or subsidy investigation
Notice of preliminary inquiry
Preliminary determination of injury
Termination if no injury or no dumping/subsidizing
Preliminary determination of dumping/subsidizing
Notice of inquiry
Possibility of accepting undertakings and suspending investigation
Provisional duty imposed
Termination if no dumping/subsidizing
Final determination of dumping/subsidizing
Public hearings
Finding
Reimbursement of temporary duty
No injury
Anti-dumping/countervailing duty imposed on dumped/subsidized imports
Injury
EXPIRY REVIEW PROCESS After five years
Decision to initiate expiry review (CITT)
Determination of the likelihood of resumed or continued dumping or subsidizing
Likelihood
Determination of Injury
No likelihood
Finding rescinded
No injury
Finding continued
Injury

Source: Canada Customs and Revenue Agency and the Canadian International Trade Tribunal

3.20 From 1993 to 2002, the CCRA received 218 inquiries from potential complainants about possible dumping or subsidizing of goods imported into Canada. After reviewing the information provided to it, the Agency concluded that an investigation was warranted in 40 cases. In these cases it found that the dumping margin ranged from 12 percent to 71 percent. Over the same period, the CITT issued 46 findings (some cases involved more than one finding), with the following results:

- 25 findings of injury to the domestic industry, duties were imposed on all subject goods imported after the date of the preliminary determination;
- 6 findings of a threat of injury to the domestic industry, duties were imposed on all subject goods imported after the date of the finding;
- 13 findings of no injury or threat of injury to the domestic industry, or no retardation to the establishment of a domestic industry, no duties were imposed; and
- In 2 cases the inquiries were suspended because the Agency accepted undertakings by exporters to change their pricing practices to eliminate the harm to Canadian industry.

3.21 From 1993 to 2002, the Tribunal conducted 43 expiry reviews. Since the implementation of the legislative amendments to the SIMA, expiry reviews are conducted jointly by the Tribunal and the Agency. The following 51 decisions were reached (some reviews involved more than one decision):

- in 29 decisions, the original finding was continued or continued with amendment; and
- in 22 decisions the original finding was rescinded.

Parliamentary review

3.22 In 1996, the Act was reviewed by two House of Commons subcommittees: the Subcommittee on the Review of *Special Import Measures Act* of the Standing Committee on Finance, and the Subcommittee on Trade Disputes of the Standing Committee on Foreign Affairs and International Trade. The subcommittees held many hearings and issued a detailed report.

3.23 The subcommittees concluded that the Act was working well overall and continued to be relevant to the competitive needs of Canadian business. In addition they concluded that the legislation adequately protected companies injured by dumped or subsidized imports, while taking into account the potential negative effects of anti-dumping and countervailing duties on consumers and downstream industries. At the same time, the subcommittees made 16 recommendations intended to make the Act more efficient and responsive to Canada's economic needs. Changes resulting from these recommendations directly affect SIMA stakeholders and users, including complainants, importers, exporters, trade experts, lawyers, and trade associations.

Focus of the audit

3.24 The audit of the *Special Import Measures Act* is part of a series of audits of the CCRA's customs programs. We examined how the Agency manages the risks for travellers at ports of entry, and we reported the results of the audit in our 2000 Report, Chapter 5. We also examined how the Agency manages the risks of non-compliance for commercial shipments entering Canada and we reported the results of that audit in our 2001 Report, Chapter 8.

3.25 This audit examined the changes to the SIMA recommended by the two parliamentary subcommittees in 1996. We assessed whether the CCRA and the CITT had put in place the support and management processes required to implement the recommended changes.

3.26 We last audited the administration of the SIMA in 1992. We noted in three subsequent reports that one of the two recommendations made in that audit has not been addressed by the Department of Finance. The recommendation called for measuring the actual extent of the impacts of trade remedies on Canadian consumers or on the Canadian economy as a whole. In light of our follow-up work after the 1992 audit, the overall findings of the major parliamentary review of the SIMA in 1996, and the relative economic significance of trade remedies, we did not examine the full complaints process or individual cases. For further details on our audit, see About the Audit at the end of this chapter.

Observations and Recommendations

Implementing the subcommittees' recommendations

3.27 In their December 1996 report, the parliamentary subcommittees listed 16 recommendations on how to make the SIMA more efficient and responsive to Canada's economic needs. Three of these recommendations did not require any government action.

3.28 The government responded to the subcommittees' recommendations in April 1997. It accepted the recommendations, except for two elements: with respect to the CITT's decision that an anti-dumping or countervailing duty might not be in the public interest, the government did not agree that this should be a formal decision subject to Federal Court review; and it did not implement the recommendation to split the responsibilities for interim reviews. However, it made commitments to implement the rest of the recommendations.

3.29 We found that effective 15 April 2000, the applicable legislation, rules, and regulations—including the SIMA and its regulations, CCRA directives, and the CITT Act and Rules—were changed to address these recommendations.

In most cases, the CCRA and the CITT have modified their management framework as required

3.30 We also examined whether the CCRA and the CITT had modified their management framework as needed for the 13 recommendations requiring action (Exhibit 3.3). We found that the management framework, including guidelines and processes, had been satisfactorily modified as required for 10 of the recommendations. Some of the changes formalized practices already in place or used infrequently.

3.31 We reviewed complaints processed since 15 April 2000, and found that they had been handled in compliance with the modified administrative processes for three recommendations. However, it is too early to determine whether the changes are achieving the results intended by the subcommittees.

Exhibit 3.3 Assessment of action taken by the CCRA and the CITT to implement recommendations of the 1996 SIMA parliamentary review

Recommendations of the parliamentary subcommittees*	Modifying management framework
The subcommittees recommend:	
1. That the SIMA legislation and process be continued, subject to the modifications addressed in this report.	N/a
2. That Revenue Canada (RC) take concrete measures to ensure fair and equal access to the SIMA process for small and medium-sized Canadian producers.	○
3. That the CITT be given the responsibility for making the preliminary determination of injury.	●
4. That SIMA be amended to provide counsel increased access to confidential information in anti-dumping/countervailing duty investigations conducted by RC.	○
5. That appropriate changes be made to Canadian trade legislation to permit access by experts to confidential information in SIMA proceedings before the CITT.	◍
6. The inclusion in SIMA Regulations of the fact of dumping in third-country markets as evidence of threat of future injury.	◍
7. That Revenue Canada make allowance in regulations to accommodate representations from interested parties when undertakings are being considered.	◍
8. That section 53(2) of SIMA be amended to allow the Deputy Minister of National Revenue to review and terminate undertakings before five years.	◍
9. That SIMA be amended to make cumulation mandatory in the CITT's procedures for determining injury.	●
10. No change from the prospective method of duty assessment.	N/a
11. That the Minister of Finance reform SIMA provisions for the conduct of interim** and expiry reviews in light of the comments made above, and in this context, to bifurcate the administrative responsibilities for the conduct of such reviews.	○
12. That section 76 of SIMA be amended to require the CITT to assess the cumulative injurious effects of dumping/subsidizing in conducting interim and expiry reviews.	●
13. That a non-exclusive list of factors be included in section 45 of SIMA that would guide the CITT respecting whether and how to conduct a public interest inquiry.	◍
14. That the CITT's decision, that an anti-dumping or countervailing duty might not be in the public interest, should be a formal decision reviewable by a Federal Court.** The level of any duty reduction should continue as at present in section 45 of SIMA to be a report to the Minister of Finance.	◍
15. That the lesser duty concept as provided in Article 9.1 of the WTO Anti-Dumping Agreement be incorporated into section 45 of SIMA provisions for public interest.	◍
16. That the Minister of Finance consider amending SIMA to allow for the temporary exemption of goods from anti-dumping/countervailing duty orders under conditions of domestic short supply.	Available in the *Customs Tariff*

* The Subcommittee on the Review of the *Special Import Measures Act* of the Standing Committee on Finance, and the Subcommittee on Trade Disputes of the Standing Committee on Foreign Affairs and International Trade

** This part of the recommendation was not accepted by the government, therefore it is not included in our assessment.

● Satisfactory
◍ Satisfactory (but no applications yet)
○ Not satisfactory
N/a Not applicable

3.31 We reviewed [illegible] processed since 15 April 2000 and [illegible] that they had been handled in compliance with the modified [illegible] processes for three recommendations. However, [illegible] determine whether the [illegible] subcommittee.

Exhibit 3.3 Assessment of action taken by the CCRA and the CITT to implement recommendations of the 1996 SIMA parliamentary review

Recommendations of the parliamentary subcommittees*	Modifying management framework
The subcommittees recommend:	
1. That the SIMA legislation and process be continued, subject to the modifications addressed in this report.	N/a
2. That Revenue Canada (RC) take concrete measures to ensure fair and equal access to the SIMA process for small and medium-sized Canadian producers.	
3. That the CITT be given the responsibility for making the preliminary determination of injury.	●
4. That SIMA be amended to provide counsel increased access to confidential information in anti-dumping or countervailing duty investigations conducted by RC.	
5. That appropriate changes be made to Canadian trade legislation to permit access by experts to confidential information in SIMA proceedings before the CITT.	○
6. The inclusion in SIMA Regulations of the fact of dumping in third country markets as evidence of threat of future injury.	○
7. That Revenue Canada make allowance in its regulations to accommodate representations from interested parties when undertakings are being considered.	○
8. That section 53(2) of SIMA be amended to allow the Deputy Minister of National Revenue to review and terminate undertakings before five years.	○
9. That SIMA be amended to make cumulation mandatory in the CITT's procedures for determining injury.	●
10. No change from the prospective method of duty assessment.	N/a
11. That the Minister of Finance reform SIMA provisions for the conduct of interim and expiry reviews in light of the comments made above, and in this context, to bifurcate the administrative responsibilities for the conduct of such reviews.	
12. That section 76 of SIMA be amended to require the CITT to assess the cumulative injurious effects of dumping or subsidizing in conducting interim and expiry reviews.	●
13. That a non-exclusive list of factors be included in section 45 of SIMA that would guide the CITT respecting whether and how to conduct a public interest inquiry.	○
14. That the CITT's decision, that an anti-dumping or countervailing duty might not be in the public interest, should be a formal decision reviewable by a Federal Court.** The level of any duty reduction should continue as at present in section 45 of SIMA to be a report to the Minister of Finance.	○
15. That the lesser duty concept as provided in Article 9.1 of the WTO Anti-Dumping Agreement be incorporated into section 45 of SIMA provisions for public interest.	○
16. That the Minister of Finance consider amending SIMA to allow for the temporary exemption of goods from anti-dumping/countervailing duty orders under conditions of domestic short supply.	[illegible]

* [illegible] ●

** [illegible]

3.32 For seven other recommendations, we could not verify whether complaints had been handled in compliance with the modifications. This was because there have not been any complaints on matters where the recommendations were applicable, since they came into effect.

Further work needed to fully implement three key recommendations

3.33 The remaining three recommendations necessitated more significant changes than the others. For these, we found that the management framework had not been satisfactorily modified and further work is needed. Concerns remain in three main areas and are as follows:

- access to confidential information,
- splitting responsibilities between the CCRA and the CITT, and
- access to the complaints process for small and medium-sized businesses.

Access to confidential information

3.34 The subcommittees recommended that counsel for the participants be granted access to confidential information in investigations conducted by the CCRA (they already had such access for investigations conducted by the CITT). The subcommittees' report presented two principal arguments for greater disclosure. First, it would allow interested parties to make rebuttal submissions to improve the quality and reliability of evidence. Second, it would result in greater procedural fairness, and lead to greater consistency with U.S. policies applied to Canadian producers exporting to the United States.

3.35 Our audit indicated that the CCRA has established guidelines to implement the SIMA changes regarding the disclosure of confidential information. Counsel must sign a disclosure undertaking, and the party being represented by counsel must sign a letter of authorization. Any breach could incur a penalty of up to $1 million.

3.36 In addition to guidelines on how the CCRA discloses confidential information, we also expected to see a system to control access to that information and keep track of submissions and requests for confidential information related to the SIMA process. The CITT has a registry system to handle the flow of documents and record all requests and sign-offs necessary to control access. The Agency does not have a registry system. The Agency's SIMA handbook provides guidance to staff on controlling the release of confidential information. However, files we reviewed showed that this guidance was not followed consistently.

3.37 The subcommittees also recommended that the appropriate changes be made to Canadian trade legislation to permit access by expert witnesses to confidential information in SIMA proceedings before the Tribunal. Expert witnesses are persons with specialized backgrounds—for example, finance, economics, manufacturing, and production—who are accepted as experts by the CITT. The CITT Act and Rules have been amended to respond to this recommendation. However, there have been no requests for such access since the changes came into effect.

The CCRA has denied complainants access to confidential information

3.38 The CCRA uses the *Special Import Measures Act* in its investigations. Since the Act did not clearly define terms such as "party" and "proceeding," the CCRA developed its own guidelines, in consultation with its legal counsel. These guidelines treat a SIMA case as a series of distinct proceedings and define which parties are eligible for access to confidential information in each proceeding (Exhibit 3.4).

Exhibit 3.4 CCRA's definition of "proceeding" and "party"

Proceeding	Eligible party
1. From filing of a written complaint under SIMA to presentation of a properly documented complaint.	• The complainant (the person submitting the written complaint). • Any other domestic producer filing the complaint as joint or co-complainant.
2. From initiation of dumping or subsidy investigation to final determination.	• Any exporter or importer actively participating in the proceeding. • The government of the country of export in a subsidy investigation.
3. Expiry review.	• Any exporter or importer actively participating in the proceeding. • Any Canadian producer of like goods. • The government of the country of export in a subsidy investigation.

Source: Canada Customs and Revenue Agency

3.39 The Canadian International Trade Tribunal Rules on the other hand define "party" generally to include the complainant, domestic producer, exporter, importer, government, association of producers, exporters or importers, or any other person entitled to be heard by the Tribunal.

3.40 On the basis of its interpretation, the Agency has denied the counsel for complainants or domestic producers access to confidential information submitted by importers and exporters in anti-dumping and subsidy investigations. The complainants were concerned that without access, their counsel could not provide relevant evidence to respond to the information provided by exporters and importers.

3.41 Two cases are now before the courts challenging the CCRA's guidelines for access to confidential information by counsel. The cases question whether the Agency's interpretation complies with the intent of the subcommittees' recommendation and the Act. Court hearings have yet to be scheduled.

Users generally satisfied confidential information will be protected but still have concerns

3.42 We interviewed some SIMA process stakeholders or "users"—trade experts, lawyers, and associations—and conducted a telephone survey. Our

The CCRA has denied complainants access to confidential information

3.38 The CCRA uses the Special Import Measures Act [illegible] since the Act did not clearly define [illegible] "party" [illegible] the CCRA developed its own guidelines [illegible] counsel. These guidelines [illegible] SIMA [illegible] and define which parties [illegible] proceeding (Exhibit 3.4).

Exhibit 3.4 CCRA's definition of "proceeding" and "party"

Proceeding	Eligible party
1. From filing of a written complaint under SIMA to presentation of a properly documented complaint.	• The complainant: the person submitting the written complaint • Any other domestic producer filing the complaint as joint or co-complainant
2. From initiation of dumping or subsidy investigation to final determination.	• Any exporter or importer actively participating in the proceeding • The government of the country of export in a subsidy investigation
3. Expiry review.	• Any exporter or importer actively participating in the proceeding • Any Canadian producer of like goods • The government of the country of export in a subsidy investigation

3.39 [illegible] define "party" [illegible] exporters, importers [illegible] importers [illegible]

3.40 On the basis of its interpretation [illegible] to complainants or domestic producers [illegible] submitted by importers and exporters [illegible] investigations. The complainants [illegible] counsel could not provide relevant [illegible] provided by exporters and importers.

3.41 Two cases are now before the [illegible] the CCRA's guidelines for access to confidential information [illegible] whether the Agency's interpretation complies with the intent of the [illegible] recommendation and the Act. [illegible]

Users generally satisfied confidential information will be protected but still have concerns

3.42 We interviewed some SIMA process stakeholders or "users" — trade experts, lawyers, and associations — and conducted a telephone survey. Our survey included the complainant or the representative of the organization named in the complaint, or else the counsel or an association, plus other participants, such as the importers.

3.43 We found that users are generally satisfied that confidential information provided to Canadian counsel by the CCRA and the CITT will remain protected. This is especially important as the information could include the producer's business plans and competitive marketing, pricing, and costing information. The Tribunal and the Agency have guidelines and procedures to protect the information and control its release. There have been no known significant breaches of confidentiality, nor any enforcement actions.

3.44 However, users are greatly concerned about giving foreign counsel access to confidential information, an issue the subcommittees did not examine. Two thirds of the complainants surveyed were not convinced that confidential information provided to foreign counsel would remain protected. To date, only the Tribunal has received such requests. It has developed guidelines for access to confidential information by domestic counsel. It has imposed additional conditions when granting access to foreign counsel on a case-by-case basis. In two cases the foreign counsel had to be under the control and direction of a domestic counsel. Domestic counsel agreed to be responsible for the way foreign counsel used and treated the confidential information. In the other case, the Tribunal imposed restrictions on the offices and locations where the foreign counsel could see the confidential information.

3.45 Counsel for participants in the SIMA process have discussed their concern about access by foreign counsel at the CITT Canadian Bar Association Bench and Bar Committee. They were concerned that non-resident counsel would be beyond the jurisdictional reach of the Tribunal and Canadian law. The CITT asked for written submissions about the issue at the January 2001 meeting but had not received any at the time of our audit. The minutes of the last meeting in October 2001 indicated that this remained a serious concern for the Bar. The Tribunal acknowledged the concerns that had been expressed but indicated that, for the time being, it remained satisfied that the rules were adequate to protect confidential information. We noted that the CITT had not consulted other user groups, such as complainants or importers, on this issue.

3.46 A further concern was access to confidential information by expert witnesses at Tribunal hearings. Over half of the complainants surveyed were concerned about giving expert witnesses access to confidential information because these persons are not necessarily affiliated with a professional body capable of holding them accountable for maintaining the confidentiality of the information.

3.47 Despite the fact that there are penalties for breach of confidentiality by counsel, users and complainants we interviewed and surveyed consistently expressed doubt that the penalties could be enforced because it would be difficult to prove a case. While penalties for breach of confidentiality also apply to foreign counsel, users are not convinced that they are enforceable outside Canada. Users said that participants in the SIMA process must be assured of confidentiality in order for the system to have integrity.

3.48 Users voiced similar concerns about the access to and control of confidential information in expiry reviews. In our telephone survey, complainants involved in expiry reviews expressed doubt that confidential information provided to foreign counsel and expert witnesses would remain protected. We noted in one review that the CCRA refused the counsel for an importer access to confidential information, because, according to the CCRA guidelines, the importer was not considered a party to the CCRA proceedings. However, the importer was a party under the CITT Rules, and the Tribunal gave the counsel for the importer access to the information during the injury portion of the proceedings.

3.49 We also heard concerns from users about confusion caused by differing CCRA and CITT requirements. Each organization required counsel to sign separate disclosure undertakings to ensure protection of confidential information (Exhibit 3.5). Sometimes the same information had to be filed with each organization. The Agency charges for copying information as required by the Special Import Measures Regulations; the Tribunal does not because it is not required by the CITT legislation. While the CCRA and the CITT both administer the SIMA, the Tribunal also operates under the CITT Act. This can result in requirements that confuse users and cause inefficiencies. Since the CCRA and the CITT are dealing with the same clients, they should continue to look for ways to reduce confusion and inefficiencies. In some cases, this may involve asking the Department of Finance to propose changes to the legislation.

Exhibit 3.5 CCRA and CITT requirements for disclosure of confidential information

Canada Customs and Revenue Agency	Canadian International Trade Tribunal
• Counsel must sign Disclosure Undertaking. • The party being represented by counsel must sign Letter of Authorization. • Counsel must represent a party to the proceeding.	• Counsel must sign Notice of Representation and Declaration and Undertaking. • Counsel must represent a party that has filed a Notice of Participation.

Source: Canada Customs and Revenue Agency and the Canadian International Trade Tribunal

3.50 **Recommendation.** The Canada Customs and Revenue Agency should put in place a registry system to control the flow of confidential information.

Agency's response. The Canada Customs and Revenue Agency agrees with the recommendation and will continue to control the flow of confidential information to ensure that there is no loss in the confidence and integrity of the handling of confidential information related to the *Special Import*

[illegible]

3.48 [illegible]

3.49 [illegible]

Exhibit 3.5 CCRA and CITT requirements for disclosure of confidential information

Canada Customs and Revenue Agency	Canadian International Trade Tribunal
• Counsel must sign Disclosure Undertaking • The party being represented by counsel must sign Letter of Authorization • Counsel must represent a party to the proceeding	• Counsel must sign Notice of Representation and Declaration and Undertaking • Counsel must represent a party that has filed a Notice of Participation

3.50 **Recommendation.** [illegible]

Agency's response. [illegible]

Measures Act (SIMA) process. In this regard, the Agency has a system to control access to confidential information, keep track of submissions and requests for confidential information, handle the flow of documents, and record sign-offs necessary to control access to confidential information. The Agency is currently implementing a registry system to centralize control of the flow of confidential information.

3.51 Recommendation. To the extent possible given their different legislative authorities, the Canada Customs and Revenue Agency and the Canadian International Trade Tribunal should develop consistent requirements for access to and protection of confidential information.

Agency's response. The Canada Customs and Revenue Agency agrees with the recommendation. The Agency recognizes that the CCRA and CITT both administer the SIMA and deal with the same clients. The Agency acknowledges the importance of minimizing confusion and inefficiencies regarding access to and protection of confidential information. The Agency will examine the administrative and procedural issues raised in the report and will develop, in consultation with the CITT and to the extent possible given the different legislative authorities, consistent requirements for access to and protection of confidential information.

Tribunal's response. As the report notes, the Tribunal is governed by a different statutory framework than the CCRA. The Tribunal is a quasi-judicial organization that has many responsibilities beyond SIMA inquiries. It is and must be seen to be independent, impartial, and at arm's length from the government and from CCRA. The CITT has developed a comprehensive and rigorous set of procedures to ensure the protection of confidential information, while preserving the rights of parties to defend their interests. These procedures have been tested and work well.

3.52 Recommendation. The Canadian International Trade Tribunal should, in consultation with the users of the SIMA, update its guidelines on the protection of confidential information to include specific procedures to deal with the disclosure of such information to foreign counsel and expert witnesses.

Tribunal's response. As noted in the report, the Tribunal has specific procedures for the treatment and protection of confidential information that apply across its various statutory mandates, including procedures for the tightly circumscribed disclosure to experts and non-resident counsel in specific cases. The Tribunal notes that, in addition to SIMA inquiries, these procedures need to cover safeguard inquiries, investigations into procurement complaints, economic, trade and tariff inquiries, and appeals of customs decisions by CCRA.

The Tribunal is currently reviewing its published guidelines on the treatment of confidential information to ensure that they fully reflects all of its current rules and procedures. The Tribunal agrees that in finalizing its revised guidelines it should take into account the views of the parties who appear before it in its full range of proceedings. The Tribunal will continue to balance the interests and protect the rights of all parties according to the law and the principles of natural justice.

Splitting responsibilities between the CCRA and the CITT

3.53 **Transfer of responsibilities from the CCRA to the CITT on preliminary determination of injury.** The parliamentary subcommittees recommended that the CITT be responsible for making the preliminary determination of injury. This had been the responsibility of the CCRA, although it could refer the matter to the CITT. Since 15 April 2000, the responsibility for making the preliminary determination has been split: the Agency is responsible for making the preliminary determination of dumping and subsidizing; the Tribunal is responsible for making the preliminary determination of injury.

3.54 The change was intended to let each organization concentrate on its area of expertise, reduce institutional duplication, provide a more streamlined and efficient system, promote greater transparency and procedural fairness, and cause unwarranted complaints to be settled or dropped earlier in the process.

3.55 The split in responsibilities has achieved some positive results. The process is perceived as being more transparent because parties can make submissions on injury earlier in the process. In addition, better use is made of the expertise of the CCRA and the CITT. Since 15 April 2000, however, no cases have been dropped at the preliminary determination stage.

3.56 **Transfer of responsibilities from the CITT to the CCRA in expiry reviews.** The subcommittees recommended splitting the administrative responsibilities for the conduct of expiry reviews: the CCRA would determine the likelihood of resumed or continued dumping or subsidizing on the expiry of a finding; the CITT would determine the likelihood of injury. Before the change, the Tribunal had conducted both parts of an expiry review. The intent of the change was to provide the same division of responsibilities as in the original determinations of dumping or subsidization and injury: the CCRA would focus on dumping and subsidizing for all cases, and the CITT would focus on injury.

3.57 **Changes in responsibilities have increased workloads.** The Agency now needs to generate more data and prepare a more formal administrative record for the Tribunal's use in making a preliminary determination of injury. The Agency's new responsibilities for expiry reviews have also increased its workload. The Agency sought and received new funding of $292,000 annually to cover additional costs. However, there was no transfer of staff from the CITT to the CCRA or change in funding for the Tribunal as a result of the transfer of responsibilities to the Agency. The Tribunal told us that it experienced essentially no reduction in its level of effort for many expiry reviews and that it had to assume the new responsibilities related to preliminary determination of injury without the allocation of new resources.

CCRA officers need additional training and guidance

3.58 To meet its new responsibilities for expiry reviews, the CCRA needed some additional expertise as well as guidance and training for its staff. Expiry reviews focus on determining the likelihood of resumed or continued dumping or subsidizing. This involves forecasting, which goes beyond determining whether dumping or subsidizing has already taken place. We expected the CCRA to identify the additional expertise and related training and guidance needed to conduct expiry reviews.

3.59 The Agency believes that its staff already have the necessary expertise to conduct expiry reviews, including the economics expertise to deal with the forecasting issues. Therefore, it assigned expiry reviews to staff based on availability or experience on other complaints casework. We are not convinced that staff had the needed economics expertise and we noted that the Agency has recently hired some economists for the Anti-dumping and Countervailing Directorate.

3.60 We found that limited training has been provided to date for staff assigned to expiry reviews. Staff did much of their learning in the process of conducting the expiry reviews. The only formal training provided was two one-day seminars, one prior to the conduct of the first expiry review, and the other after the first two expiry reviews were completed. Recently an overview of the expiry review was included in the orientation course for new staff. We also noted that there is little guidance on expiry review procedures in the SIMA handbook.

The CCRA is in the initial phase of examining expiry review procedures

3.61 After completing the first two expiry reviews, the Agency revised some of its expiry review guidelines in July 2001. However, the Directorate decided that another procedural review was necessary to modify policy, procedures, work instruments, and expiry review case management. Staff identified 24 issues that needed to be addressed. The aim of this review was to improve the efficiency and effectiveness of the processes while respecting principles of natural justice, procedural fairness, legal obligations, and client service objectives.

3.62 The Directorate Management Committee approved the proposal for this review in early May 2002. It was in its first stage at the time of our audit. This will be followed by consultations with the CITT and the public. The review was expected to lead to further revisions of the CCRA guidelines on conducting expiry review investigations, a comprehensive revision of the SIMA handbook on expiry review procedures, and training for staff and management in the new procedures. However, there is no timetable for each stage or for completion of the entire review. Furthermore, we are concerned that the review does not place more emphasis on staff training for expiry reviews.

3.63 We also noted that the Anti-Dumping and Countervailing Directorate itself is facing other pressures. In particular, it experienced a high staff turnover since April 2000: 18 departures and 30 new hires, resulting in a net increase of 12 to bring the total staff to 105. Most of the staffing was done in 2002 in anticipation of the retirement of senior staff over the next five years. We also noted that among the new hires, almost all commerce officers were at an entry level while those who were departing were at more senior levels. We are concerned that this could lead to a knowledge gap within the Directorate, a small unit within the Agency that requires specific expertise and knowledge. The Directorate's need to build up its capacity to carry out its responsibilities is increasingly urgent.

Complaints and expiry reviews are becoming more expensive and time-consuming

3.64 We surveyed a variety of users including Canadian producers who file complaints and importers that respond to those complaints. About 70 percent of complainants we surveyed felt that the process was too costly for them. They reported that the cost for external counsel for each participant could range from $100,000 to $500,000 for parties to participate in the entire SIMA process. In one case the cost exceeded $1 million for the complainant and in another case it exceeded $1 million for the importer. The cost for external counsel for each participant could range from $50,000 to $100,000 for an expiry review. These costs have caused hardship, particularly for small and medium-sized Canadian producers. However, much of the cost is due to the nature and complexity of the process and the need to comply with international agreements.

3.65 Part of the increasing costs is likely due to the split of responsibilities. Now that the CITT is responsible for the preliminary determination of injury, user costs may rise if counsel's advice is needed earlier in the SIMA process. The expiry review process has become more expensive and time-consuming. In the past, when the CITT had full responsibility for expiry reviews, briefs and arguments on dumping and injury were presented concurrently. Now they are presented separately, which raises user costs. On the other hand, costs may be lower than before in cases where the CCRA finds no likelihood of dumping or subsidizing. In those cases, the CITT would cease its review for the likelihood of injury. Since April 2000, two cases were dropped after the CCRA had completed its investigations.

3.66 While the splitting of responsibilities has increased costs, users told us that the potential benefit of the changes is not yet apparent. We noted that the Agency and the Tribunal have made some efforts to work together. When part of the expiry review responsibilities were first transferred from the CITT to the CCRA, sessions were held to develop a joint questionnaire and working tools. In our view, more needs to be done to ensure that the expiry review process is as efficient and effective as possible so that Parliament's intentions in splitting the process are achieved. It would be beneficial for the CCRA and the CITT to conduct a review that would highlight the difficulties and inefficiencies in the expiry review process. The review could also point out the need for possible policy changes that would have to be addressed by the Department of Finance.

3.67 **Recommendation.** The Canada Customs and Revenue Agency should do the following:

- provide additional training and guidance to support the conduct of expiry reviews,
- develop an action plan with timelines for its review of the expiry review process, and
- identify any remaining administrative difficulties or inefficiencies in the expiry review process and work with the Canadian International Trade Tribunal to resolve them.

Agency's response. The Canada Customs and Revenue Agency agrees with the recommendation and acknowledges the importance and priority of training its staff. In this regard, the Agency will continue to provide training to all staff directly and indirectly involved with expiry reviews. In addition, the Agency will develop and enhance its training programs, training instruments and administrative policies to supplement existing training plans in order to ensure that all staff receive sufficient training for the conduct of expiry reviews.

An action plan with timelines for the review of the expiry review process will be developed by the end of December 2002.

The Agency will continue to review and identify any remaining administrative difficulties or inefficiencies in the expiry review process. The Agency is currently in the process of reviewing its expiry review procedures and will subsequently consult with the CITT and the public. The Agency will work with the CITT to resolve, to the extent possible, any administrative difficulties and inefficiencies resulting from differing or inconsistent organizational requirements.

3.68 **Recommendation.** The Canadian International Trade Tribunal should review the expiry review process to identify administrative difficulties or inefficiencies and work with the Agency to resolve them.

Tribunal's response. The introduction of the bifurcated expiry review process has caused some administrative difficulties. However, because there have been relatively few expiry review cases that have been fully conducted under the new regime since April 2000, it may be premature to draw conclusions.

The Tribunal is currently reviewing its expiry review procedures in light of the experience to date in order to identify both difficulties and potential solutions. In areas where the separate process of the Tribunal and the CCRA interact with one another, Tribunal staff will work with CCRA staff to find ways to reduce the difficulties, while respecting the independence and impartiality of the Tribunal.

Access for small and medium-sized businesses

Small and medium-sized Canadian producers face several barriers

3.69 The subcommittees recommended that the CCRA take concrete measures to ensure fair and equal access to the SIMA process for small and medium-sized Canadian producers. Although no formal definition of "fair and equal access" exists, the Agency has generally taken it to mean a situation in which no industry sector or size of business has an advantage over another in gaining access to the SIMA process.

3.70 The CCRA consulted stakeholders to discuss the SIMA process after the subcommittees prepared their report. However, it did not use the findings of the consultations to systematically identify the access barriers faced by small and medium-sized producers, their relative importance, and ways of overcoming them. Nevertheless, the consultations, as well as the Agency's contact with producers in the course of administering the Act, have given the CCRA a sound appreciation of the barriers. They include the following:

- the costs of complying with SIMA requirements, including a significant paper burden;
- the complexity, formality, and duration of the process;
- lack of knowledge and expertise among producers about SIMA and relevant procedures; and
- the need to work together with other small producers, or through producer associations.

3.71 CCRA officials recognize that all producers encounter barriers in the SIMA process. Some are inevitable, given Canada's obligations to its trading partners and the need to ensure that the decisions will meet the tests established by WTO and NAFTA trade dispute panels, and by the Federal Court. Officials also recognize that the barriers, particularly the costs involved, are more formidable for smaller producers than for big producers.

3.72 The barriers identified by the CCRA both formally and informally correspond closely with those identified by stakeholders we consulted during the audit. These stakeholders were mostly associations representing small and medium-sized producers.

The CCRA plans and initiatives for small and medium-sized producers have stalled

3.73 Following the subcommittees' report and the government's April 1997 response, the CCRA moved quickly to develop a coherent approach to the unique problems faced by small and medium-sized producers. Between April 1997 and February 1998, it gave 20 SIMA presentations to government organizations dealing with small businesses, established a Web page to provide ready access to SIMA-related materials, and revised its procedures with the intention of providing at least two weeks of direct assistance to any small or medium-sized producer preparing a complaint. However, we noted that the CCRA's Anti-dumping and Countervailing Directorate Web pages can be difficult for a first time user to find.

3.74 The CCRA reviewed the practices of some of Canada's trading partners concerning small and medium-sized companies. The World Trade Organization Anti-Dumping Agreement recognizes the difficulties faced by small companies, and directs the authorities of member countries to provide them with practicable assistance. The CCRA also found that other countries have mechanisms to support and assist business, particularly small and medium-sized producers.

3.75 On the basis of these reviews and the actions already under way, in February 1998 the Agency produced a plan to further respond to the recommendation by taking the concrete steps urged by the subcommittees. The plan called for the following three groups of activities:

- promoting and raising the visibility of the SIMA program in general by assigning clear responsibility for information dissemination and developing an organized communications strategy;
- a pilot project to test revised procedures by assisting certain small and medium-sized producers that want to file a complaint, and getting feedback from them on the service received and their level of satisfaction with it; and
- proposing a process to analyze and assess other steps that might be taken to improve accessibility, including possible legislative, policy, and administrative changes.

3.76 The plan was approved and action began on its implementation. However, an October 1998 memorandum to all staff noted that the project had been put on hold because of budgetary constraints. The memorandum also indicated that access for small and medium-sized producers remained a priority. It urged staff to continue making efforts and seeking innovative ways of improving SIMA accessibility, including providing assistance when requested.

3.77 Since 1999 the Agency has undertaken further planning and action on improving access within the context of its Continuous Process Improvement initiative. The aim of the initiative was to improve client service and use the Agency's resources efficiently. In recent years the focus has been on improving SIMA administrative practices in general, instead of outreach activities specifically designed to improve access for small and medium-sized Canadian producers.

3.78 At the time of this audit, the amount of direct assistance provided by the Agency to small and medium-sized producers varied according to the requests made, resource availability, and staff workload at any given time.

3.79 Further, the CCRA does not have an operational definition of small and medium-sized Canadian producers for SIMA purposes. Without this definition, the Agency has not been able to target its activities to a specific group of producers; nor has it had a basis for measuring its performance by reference to such a group of producers. In our view, this has made it difficult for the Agency to design and target concrete measures to respond to the subcommittees' recommendation, and to assess how well it has ensured fair and equal access.

3.80 To act on Parliament's intent of ensuring fair and equal access to the complaints process for small and medium-sized Canadian producers, more focussed efforts are required. In our view, little progress can be achieved without systemic support to reduce costs. Further, the CCRA needs indicators to periodically assess its performance in implementing the subcommittees' recommendation that concrete measures be taken to ensure fair and equal access to the SIMA process for small and medium-sized Canadian producers.

3.81 **Recommendation.** The Canada Customs and Revenue Agency should do the following:

- move quickly to develop and implement measures to provide more support and assistance to small and medium-sized Canadian producers, and
- develop and use indicators to periodically assess its performance in implementing the subcommittees' recommendation that concrete measures be taken to ensure fair and equal access to the SIMA process for small and medium-sized Canadian producers.

Agency's response. The Canada Customs and Revenue Agency agrees with the recommendation. The Agency recognizes the difficulties faced by small companies and the importance of providing them with practicable assistance. In this regard, the Agency has taken steps to improve SIMA administrative practices, to provide direct assistance, and to improve accessibility of the SIMA process to small and medium-sized Canadian producers. The Agency will explore options to develop and implement measures to provide more support and assistance to small and medium-sized Canadian producers.

The Canada Customs and Revenue Agency agrees with the recommendation. The Agency recognizes the importance of the generation and use of meaningful performance measures. The Agency will explore opportunities and prepare an action plan to develop and use indicators to periodically assess its performance in implementing the subcommittees' recommendation that concrete measures be taken to ensure fair and equal access to the SIMA process for small and medium-sized Canadian producers.

Conclusion

3.82 The government has implemented most of the recommendations of the parliamentary subcommittees on the SIMA. The applicable legislation and regulations were changed, and the CCRA and the CITT have modified their management framework. Our audit highlighted some areas where improvements are needed to fully implement the recommendations. These include issues related to granting counsel access to confidential information, splitting responsibilities between the CCRA and the CITT, and working to ease access to the SIMA process for small and medium-sized producers. More work is needed in these areas if the Agency and the Tribunal are to achieve the results Parliament expected.

3.83 Recent years have seen an increasingly heavy financial, time, and information burden associated with participating in the SIMA process. As a result, it has become more difficult to reduce the inevitable barriers to accessing the complaints process. The CCRA and the CITT face the challenge of continuing to improve their management framework and administrative process. In this audit, we have identified opportunities for improving and streamlining CCRA and CITT administrative processes. In our view, the Agency and the Tribunal must find innovative ways to lessen the procedural burden in order to help ensure that the SIMA is an efficient and cost-effective trade remedy system.

About the Audit

Objectives

The objectives of our audit were the following:

- to assess whether the Canadian Customs and Revenue Agency and the Canadian International Trade Tribunal had put in place the support and management processes required to implement the changes to the *Special Import Measures Act* recommended by parliamentary subcommittees in 1996, and
- to identify opportunities for improving the application of the modified management framework.

Scope and approach

After our 1992 SIMA audit, two parliamentary subcommittees conducted a significant review of the Act in 1996. Their report contained 16 recommendations, 13 of which required legislative and administrative changes. This audit focussed on whether the CCRA and the CITT have put in place the support and management processes to implement those changes, as required.

Our examination included a review of relevant legislation, regulations, processes, guidelines, and files of selected complaints. The aim was to ensure that the management framework had been modified and applied appropriately. We carried out our work at the CCRA's headquarters and at the CITT in Ottawa.

During our examination we studied documents and interviewed CCRA and CITT managers and staff, as well as selected stakeholders or users of the SIMA process, including complainants, importers, trade experts, lawyers, and associations. We also conducted a telephone survey of 29 users, including small, medium-sized and large companies to learn how they perceived the way in which the complaints and expiry review processes were administered. In addition, our survey covered some people who had made inquiries with the CCRA and had asked for assistance in the documentation of a complaint. We requested their views on access to the complaints process.

Criteria

The criteria for our audit were drawn from the recommendations of the 1996 SIMA parliamentary review, and from the relevant regulations and guidelines. We expected to see the following:

- the legislation, rules, and regulations had been changed to address the recommendations of the parliamentary subcommittees;
- the CCRA and the CITT had modified the management framework as required to reflect the changes recommended by the parliamentary subcommittees; and
- the CCRA had taken concrete steps to ensure fair and equal access to the complaints process for small and medium-sized Canadian producers.

Audit team

Assistant Auditor General: Douglas Timmins
Principal: Jamie Hood
Director: Lilian Goh

Paul Atkinson
Wilson Ford

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Appendix The SIMA findings and orders in force as of 31 March 2002

Date of decision	Product	Country	Date of original decision*
11 April 1997	Polyiso insulation board	United States	
21 April 1997	Machine tufted carpeting	United States	21 April 1992
27 June 1997	Concrete panels	United States	
20 October 1997	Certain waterproof rubber footwear	China	25 May 1979
27 October 1997	Certain hot-rolled carbon steel plate	Mexico, China, South Africa, and Russian Federation	
28 November 1997	Fresh iceberg (head) lettuce	United States	30 November 1992
10 December 1997	Bicycles and frames	Chinese Taipei and China	11 December 1992
29 April 1998	Certain prepared baby foods	United States	
4 September 1998	Certain stainless steel round bar	Germany, France, India, Italy, Japan, Spain, Sweden, Chinese Taipei, and United Kingdom	
18 November 1998	Preformed fiberglass pipe insulation	United States	19 November 1993
17 May 1999	Certain hot-rolled carbon steel plate and high-strength low-alloy plate	Italy, Korea, Spain, and Ukraine	17 May 1994
18 June 1999	Certain stainless steel round bar	Korea	
22 June 1999	12-gauge shotshells	Czech Republic and Republic of Hungary	22 June 1994
2 July 1999	Certain flat hot-rolled carbon and alloy steel sheet products	France, Romania, Russian Federation, and Slovak Republic	
19 July 1999	Black granite memorials and black granite slabs	India	20 July 1994
28 July 1999	Certain corrosion-resistant steel sheet products	Brazil, Germany, Japan, Korea, and United States	29 July 1994
27 August 1999	Certain cold-rolled steel sheet products	Belgium, Russian Federation, Slovak Republic, and Turkey	
12 January 2000	Certain concrete reinforcing bar	Cuba, Korea, and Turkey	
20 March 2000	Subsidized canned ham	Denmark and Netherlands	7 August 1984
1 May 2000	Iodinated contrast media	United States (including the Commonwealth of Puerto Rico)	
1 May 2000	Women's boots	China	3 May 1990
5 June 2000	Carbon steel welded pipe	Korea	28 June 1983
27 June 2000	Certain carbon steel plate	Brazil, Finland, India, Indonesia, Thailand, and Ukraine	
1 August 2000	Certain refrigerators, dishwashers, and dryers	United States	
13 September 2000	Whole potatoes	United States	4 June 1984
27 October 2000	Certain stainless steel round bar	Brazil and India	
3 November 2000	Refined sugar	United States, Denmark, Germany, Netherlands, United Kingdom, and European Union	6 November 1995
8 December 2000	Waterproof footwear and bottoms	China	
2 May 2001	Garlic, fresh or frozen	China and Vietnam	
1 June 2001	Certain concrete reinforcing bar	Indonesia, Japan, Latvia, Republic of Moldova, Poland, Chinese Taipei, and Ukraine	
24 July 2001	Certain carbon steel welded pipe	Argentina, India, Romania, Chinese Taipei, Thailand, and Brazil	26 July 1991
17 August 2001	Certain flat hot-rolled steel sheet and strip	Brazil, Bulgaria, China, Chinese Taipei, India, Macedonia, South Africa, Ukraine, and Yugoslavia	
27 December 2001	Leather footwear with metal toe caps	China	
20 March 2002	Fresh garlic	China	21 March 1997

*The Canadian International Trade Tribunal found injurious dumping has continued since this date (see paragraph 3.19 for an explanation of expiry reviews)

Source: Canadian International Trade Tribunal, *Annual Report*, 2002

Report of the Auditor General of Canada to the House of Commons—December 2002

Main Table of Contents

Matters of Special Importance—2002
Foreword and Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada—Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada—Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

Appendices

2002

Report of the
Auditor General of Canada
to the House of Commons

DECEMBER

Chapter 4
Canada Customs and Revenue Agency—
Taxing International Transactions
of Canadian Residents

Office of the Auditor General of Canada

The December 2002 Report of the Auditor General of Canada comprises 11 chapters, Matters of Special Importance—2002, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

Ce document est également disponible en français.

© Minister of Public Works and Government Services Canada 2002
Cat. No. FA1-2002/2-12E
ISBN 0-662-33110-9

Chapter

4

Canada Customs and Revenue Agency

Taxing International Transactions of Canadian Residents

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

Table of Contents

Main Points 1

Introduction 3

The Agency's International Tax Program 3
Focus of the audit 6

Observations and Recommendations 6

Assessing international tax risk 6
National program guidelines can be improved to better reflect an overall assessment of international tax risk 6
International audit planning for large corporate audits must be improved 8
Tools must be applied to select small and medium businesses for international audits 9
Better information is needed to identify international tax risk 9

Audit skills are developing slowly 11

Audit management must be strengthened 13
Obtaining foreign-based information from taxpayers in a timely way is essential 13
Good global business knowledge is important 14

Management information for program planning 16

Conclusion 17

About the Audit 18

Canada Customs and Revenue Agency

Taxing International Transactions of Canadian Residents

Main Points

4.1 The Canada Customs and Revenue Agency verifies that Canadian residents have complied with the tax rules on international transactions through audits carried out by specialized international auditors across the country. Our audit found that better risk assessment is needed to determine what compliance work should be undertaken in each tax services office and on a national basis. This is needed in order to provide an adequate check on the assessment of tax revenue from international transactions.

4.2 Expert staff is essential for an effective international audit program. The Agency must find ways to improve the program's human resource capability at a faster rate and explore ways to ensure that complex international audits are completed in a timely manner. In the Toronto area where 40 percent of large corporations file their tax returns, economic conditions have made recruiting and retaining international auditors difficult. The current staffing and level of training activities may not address this problem. In some tax services offices over one-third of the international audit staff have less than one year's experience and still require some training. Other staff, including some auditors of large corporations and auditors of small and medium businesses who were recruited without previous international tax experience still require basic international tax training.

4.3 The Agency needs to be more effective in carrying out audits of international issues. Strengthening its ability to provide advice on international business practice and providing economic analysis earlier in the audit process would reduce the time over which international audits are completed. The international audit program needs better information on the resources used to complete the audit of international issues, the tax reassessed, and the issues identified in reassessments in order to determine its future resource requirements and program directions.

Background and other observations

4.4 Canadian residents pay tax in Canada on their worldwide income. This includes the profits derived from sales of goods and services to non-residents, and dividends, capital gains, and interest resulting from their investments in foreign corporations or other foreign entities such as trusts.

4.5 There are specific rules that deal with the taxation of foreign transactions of Canadian residents. For example, transfers of goods and services between related parties must take place at arm's length prices. The foreign affiliate rules and the foreign accrual property income rules of the

Canadian *Income Tax Act* deal with dividends and other income from investments in foreign entities. Data reported by taxpayers to the Agency indicates that Canadian investments in foreign-related corporations and the value of cross border trade between companies within the same corporate group has increased significantly in recent years.

4.6 The International Tax Directorate of the Canada Customs and Revenue Agency administers the tax rules on international transactions with the assistance of several other divisions within the Agency. To ensure that taxpayers comply with the complex tax rules related to international transactions, the Agency uses information obtained from various sources, including information provided by taxpayers in tax returns and in other information returns. Based on this information, auditors select files and conduct audits on the international transactions made by taxpayers.

The Agency has responded. The Canada Customs and Revenue Agency agrees with our recommendations and in its responses, has indicated the actions it will take to address them.

Introduction

4.7 The Canadian tax rules that cover international transactions can be divided into two broad dimensions. In December 2001 we reported on how the Agency administers the tax rules for Canadian source income of non-residents. This Report covers how the Agency administers the tax rules for international transactions that involve Canadian residents. These tax rules include relevant sections of the *Income Tax Act* and Regulations as well as provisions of tax agreements between Canada and other countries.

4.8 Canadian residents pay tax in Canada on their worldwide income. If they carry on business outside Canada it may be either directly, or through related companies that are resident in other countries. If they invest in foreign corporations or have an interest in a foreign trust they may receive income such as interest, dividends, and capital gains.

4.9 Between 1996 and 2000, the amount of money that Canadian-resident corporations loaned to, and invested in foreign affiliates has increased from $200 billion to over $450 billion. The Agency collected data which indicates that Canada's top 50 corporations have over 1,300 foreign-affiliated corporations, trusts, and partnerships scattered throughout the world. This data also shows that the trade in goods and services within these corporate groups was over $250 billion in 2000, while the value of dividends and interest received in Canada from investments in these related entities was over $3 billion.

4.10 Foreign investments pose risks to Canada's tax base. The income from foreign investments is not as visible as Canadian source income and is more difficult to identify and verify. Income and capital gains may be diverted to tax havens and countries with preferred tax regimes to avoid Canadian tax. To encourage compliance and assist in identifying those risks, taxpayers must report details of their foreign investments.

4.11 In the last decade foreign trade has increased from 50 percent of gross domestic product to over 80 percent. More than 50 percent of Canada's international trade is between related parties such as a Canadian corporation and its foreign affiliates. Canadian tax rules require that the buying and selling of goods and services between related parties must take place at arm's length prices. Canadian companies may attempt to reduce the income they report in Canada either by selling goods and services to foreign-related parties at prices that are lower than arm's length prices, or by purchasing goods and services from related parties at prices that are higher than arm's length prices.

The Agency's International Tax Program

4.12 The International Tax Directorate, located in the Agency's headquarters in Ottawa, and the international audit program in tax services offices across the country are the focal point of the Agency's International Tax Program.

4.13 The International Tax Directorate [illegible] Branch was established in November 2001 [illegible]

4.14 The Directorate [illegible]

Exhibit 4.1 Divisions of the International Tax Directorate responsible for taxation of international transactions of Canadian residents

Canada Customs and Revenue Agency

Compliance Programs Branch

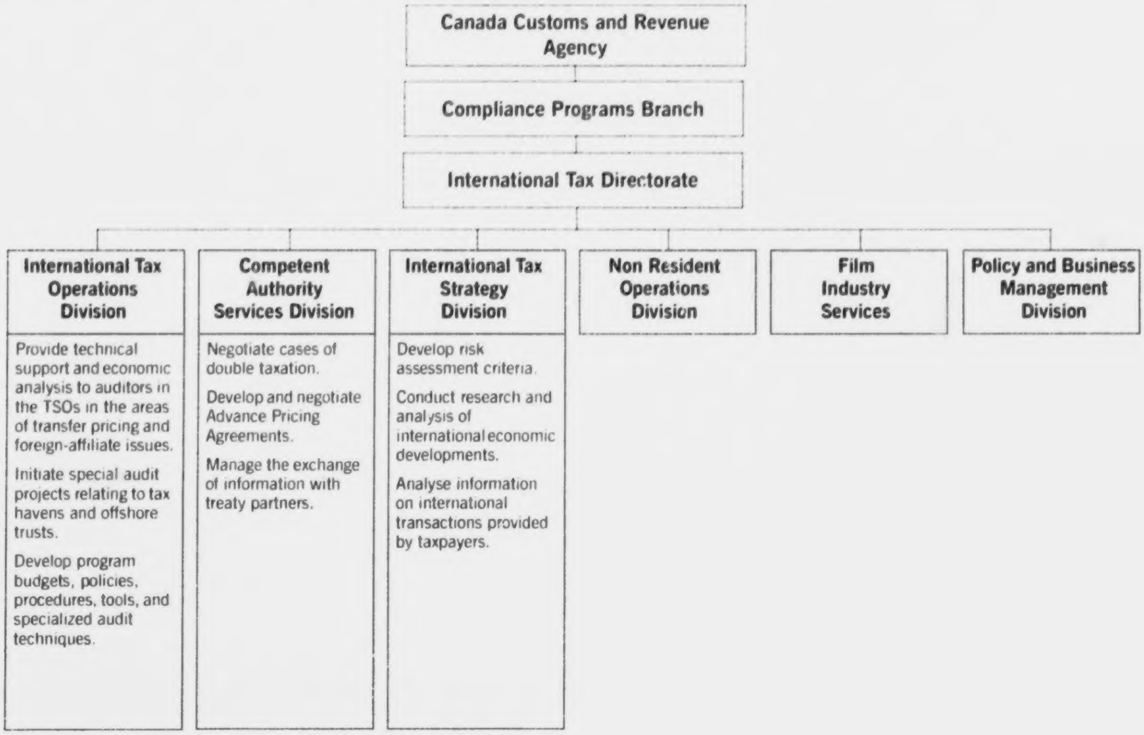
International Tax Directorate

International Tax Operations Division	Competent Authority Services Division	International Tax Strategy Division	Non Resident Operations Division	Film Industry Services	Policy and Business Management Division
Provide technical support and economic analyses to auditors in the TSOs in the areas of transfer pricing and foreign affiliate issues. Initiate special audit projects relating to tax havens and offshore trusts. Develop program budgets, policies, procedures, tools, and specialized audit techniques.	[illegible] Review and negotiate Advance Pricing Agreements. Manage the exchange of information with treaty partners.	[illegible] [illegible] Analyze information on international transactions provided by taxpayers.			

4.13 The International Tax Directorate, a part of the Compliance Programs Branch, was established in November 1991 to enable the Agency to respond to international tax issues in a consistent and timely way. The Directorate's role is to develop and refine tax administration programs and systems to ensure that Canadians and non-residents comply with the legislation and treaties that apply to international transactions. The Directorate also provides guidance on policy matters, and technical assistance to the tax services offices on international tax issues. In this year's audit we focussed on the divisions of the International Tax Directorate with responsibilities for the taxation of international transactions of Canadian residents (Exhibit 4.1).

4.14 The Directorate personnel participate in working groups of the Organization for Economic Co-operation and Development. These working groups study ways to avoid double taxation, prevent fiscal evasion, and ensure that the application of transfer-pricing guidelines, legislation, and practices are in line with tax treaties. They also participate at meetings of the Pacific Association of Tax Administrators and the Seven Countries Tax Haven Group to share information on common international tax issues and best practices. One of the Association's current initiatives is to develop a model documentation package that taxpayers could prepare to avoid penalties.

Exhibit 4.1 Divisions of the International Tax Directorate responsible for taxation of international transactions of Canadian residents


Canada Customs and Revenue Agency
Compliance Programs Branch
International Tax Directorate
International Tax Operations Division
Competent Authority Services Division
International Tax Strategy Division
Non Resident Operations Division
Film Industry Services
Policy and Business Management Division

International Tax Operations Division

Provide technical support and economic analysis to auditors in the TSOs in the areas of transfer pricing and foreign-affiliate issues.

Initiate special audit projects relating to tax havens and offshore trusts.

Develop program budgets, policies, procedures, tools, and specialized audit techniques.

Competent Authority Services Division

Negotiate cases of double taxation.

Develop and negotiate Advance Pricing Agreements.

Manage the exchange of information with treaty partners.

International Tax Strategy Division

Develop risk assessment criteria.

Conduct research and analysis of international economic developments.

Analyse information on international transactions provided by taxpayers.

Source: Canada Customs and Revenue Agency if an audit indicates that sales to and purchases from related parties have not taken place at arm's length prices. The objective is to have a documentation package that will meet the requirements of the four member-countries.

4.15 Over the last five years, the Directorate has more than doubled in size, from 80 to 200 employees. The number of Directorate staff assigned to support the international audit program in the tax services offices has increased from 10 to 46.

4.16 While the Directorate provides overall program direction and administrative guidance, the tax services offices across the country carry out the bulk of the audit activities. In 2001–02 there were 238 international audit staff in 31 tax services offices. Plans call for a total of 278 staff by the end of 2002–03.

4.17 International auditors in tax services offices across the country carry out audits; if they determine that the taxpayer's taxable income or tax liability needs to be adjusted, a tax reassessment statement is issued to the taxpayer. These auditors interact with other staff throughout the Agency to complete the audit. In the tax services offices the international auditors can select files for audit or work on files referred by auditors examining domestic transactions. In the case of large corporations the Agency's policy is to review the returns of 875 corporations with gross revenue of more than $250 million, for each tax year. Large-file case-managers co-ordinate all aspects of these audits.

4.18 Three field advisory units provide expert advice on foreign-affiliate and other international tax rules to the auditors in the tax services offices. Each field advisory unit has eight to ten employees located in Ottawa. Within these units the Directorate currently employs six economists to assist the international auditors in completing transfer-pricing audits. In addition, there is one technical advisor who resides in each of the six regions and who is also responsible for providing advice on technical issues to international auditors in their region.

4.19 The Agency also has 18 industry specialists, located in tax services offices across the country. International auditors can consult these industry specialists for advice on tax and business issues specific to industry sectors, such as financial institutions, forestry, and information technology.

4.20 The international auditors can also refer matters through the International Tax Directorate to the International Sections of the Income Tax Rulings Directorate, Policy and Legislation Branch, or to the Agency's Legal Services Unit. This is done in cases where auditors want a determination of how the tax laws should be interpreted in relation to the facts of a taxpayer's specific situation. These referrals are often necessary given the complex nature of the international tax rules, and the organization, and transactions of multinational businesses.

4.21 If at the end of an audit an international auditor determines that the taxable income reported by a related party in another country should have been reported by the taxpayer in Canada, this can result in the taxation of the same income in two countries. If a tax treaty exists between Canada and the other country, the taxpayer can request the assistance of the Competent Authority Services Division for relief from double taxation. The staff of the Division, including both auditors and economists, will review the case and attempt to resolve the matter with their counterpart in the other country. In the past year the Division participated in resolving the issues in over 100 requests for competent authority assistance. The taxpayer may also file a notice of objection with the Agency's Appeals Branch.

4.22 The performance report prepared by the International Tax Directorate indicates that in the year ending 31 March 2001, international auditors had completed 1,430 cases and reassessed an additional amount of about $778 million in taxes. Over 350 of these cases involved international transactions made by large corporations that resulted in tax reassessments of over $300 million.

Focus of the audit

4.23 The objective of the audit was to determine whether the procedures which the Agency is currently using provide an adequate check on the assessment of tax revenues from the international transactions of Canadian residents.

4.24 Our audit focussed on several questions: Does the Agency have a risk assessment and a compliance strategy to manage the risks to the taxation of international transactions? How effectively has it carried out its activities to verify compliance with the rules? Has it reported its performance accurately? How well does its functional guidance and assistance support the operational activities of its tax services offices? We placed particular emphasis on the Agency's review of international transactions of Canada's largest corporations. Further information about the audit objectives, scope, approach, and criteria can be found at the end of the chapter in About the Audit.

Observations and Recommendations

Assessing international tax risk

4.25 Our view is that the international audit program's national priorities to allocate resources should be based on an assessment of which taxpayers and types of transactions are most at risk of being non-compliant with the tax rules relating to international transactions. Compliance risks exist in international transactions involving large corporations, as well as smaller businesses, individuals, partnerships, and trusts, and need to be fully identified and assessed to appropriately allocate resources.

National program guidelines can be improved to better reflect an overall assessment of international tax risk

4.26 Annually the International Tax Operations Division prepares national planning guidelines directing how tax services offices should allocate their international audit resources between various types of international audits.

The original guidelines for 2002–03 indicate that 51 percent of international audit workload in tax services offices should be directed to individual audits and audit projects identified by the International Tax Directorate or international auditors in the tax services offices. The guidelines indicate that 49 percent of the workload should be directed to assistance on files selected for audit by domestic auditors. This allocation of audit resources should better relate program activities to an overall identification and assessment of the international tax risk presented by different taxpayers or types of transactions.

4.27 A project originally identified as needing significant resources for 2002–03 was the completion of the audit of income of taxpayers involved in foreign trusts. The foreign trust project was initiated in 1999 and the resources currently allocated to the project are based on an estimate that there was $400 million in additional income to be reassessed in Canada in relation to specific offshore trusts, and the associated Canadian taxpayers which were selected for audit. The results to date show that fewer than 60 percent of the completed audits have resulted in non-compliance being identified. Other files are still under audit.

4.28 However, the Agency does not yet have a final position on reassessing the Barbados spousal trusts we noted in our 2001 Report, Chapter 7, International Tax Administration: Non-Residents Subject to Canadian Income Tax. International audit staff which were allocated to this task are not trained to enable them to complete this project work in 2002–03.

4.29 The original program guidelines were modified after discussions with the tax services offices. The final national planning guidelines for this year call for 56 percent of the auditor's workload to be allocated to assisting domestic auditors in completing audits of international issues. This is a reduction from the 65 percent of the previous year, but with a slight increase in the number of cases to be completed due to an increase in staff. In audits completed in previous years, we observed cases where international issues identified for audits had been deferred or delayed because international audit staff were not available. With the number of resources assigned to this task, international auditors have not been able to meet the objective of the international audit program that is to participate in all audits of large corporations. This was the case in all of the large tax services offices we visited.

4.30 The Agency says that the program guidelines are based on the assessment and weighing of various risk factors. However, we have seen little information and analysis concerning the assessment of international tax risk, in different types of files. Nor did we see the basis for weighing these risks that would support the current allocation of international audit resources. More needs to be done to improve the information and analysis to evaluate international tax risks and support program guidelines.

International audit planning for large corporate audits must be improved

4.31 Identifying specific transfer prices and international transactions of a large corporation that may not be in compliance with Canada's tax laws or treaties is a complex process. To effectively identify and assess the risk of non-compliance with tax rules in international transactions, international auditors need to know how different businesses operate worldwide and be able to interpret the international information provided on the various documents filed by a taxpayer. As well, auditors must gather significant additional information about large corporate taxpayers before a decision can be made to focus an audit on a specific transaction or issue.

4.32 A concern with inadequate audit planning was raised by the International Audit Quality Assurance Review, which was undertaken by the Agency in six tax services offices in the past two years. In our audit work we reviewed some ongoing audits to see if the concern raised by the Quality Assurance Review had been addressed. Several large corporate international audits were proceeding with no specific international audit issues identified and documented in the audit planning documents used internally. In addition, specific international audit issues were not identified in the letter sent to the taxpayers giving details of the audit including specific issues and transactions to be examined.

4.33 Currently the international audit program in the tax services offices is required to provide audit staff to identify and audit the international tax issues in a large corporation when the large-file case-manager starts the audit. This assistance is required in the audit of 875 major corporations and the 7,700 Canadian corporations they control. It includes reviewing the international transactions between all of these corporations and their foreign affiliates.

4.34 The international audit section in the tax services offices would be better able to plan the international component of large corporate audits, and to apply its limited audit resources to the audits with the greatest risks of non-compliance if the relative international tax risk in the large corporations that will be audited that year could be assessed in advance. This annual planning would indicate to the International Tax Directorate and senior managers responsible for the audit of large corporations in tax services offices what international tax risks the international auditors have identified but would not be able to address in an audit this year. This level of international tax risk assessment and workload planning for the audit of large corporations would also be useful in identifying overall international tax risk for consideration in future program guidelines.

4.35 We have also observed that the time and resources applied to international audit planning could be used more effectively if a co-ordinated risk identification model was available to provide guidance in identifying and assessing the risk of non-compliance in international transactions in a particular corporate group. The development and use of such a model would provide consistency in the international audit approach and assist in the training of international auditors.

Tools must be applied to select small and medium businesses for international audits

4.36 Domestic auditors also need to apply tools to screen for international issues in a more systematic way for risk assessment purposes when identifying small and medium companies for audit. In the past two years international auditors have received few requests for their assistance in auditing international transactions of small and medium companies. The data in the Agency's information management system show that few audits of international transactions of small and medium companies were completed by domestic auditors. Some international compliance issues have been identified in these companies by international auditors.

4.37 Currently auditors of small and medium companies do not consistently screen the data provided by taxpayers on international transactions and investments in non-residents who are related to them. Also the auditors need additional training to properly access and utilize the different databases in selecting companies for audit. New screening tools being developed by the International Tax Strategy Division could be used by auditors of small and medium companies to identify international tax risk.

Better information is needed to identify international tax risk

4.38 Beginning in 1996 Canadian residents were required to report ownership interests in foreign affiliates, transfers of property or loans to a foreign trust, and distributions from foreign trusts. Since 1998 they must also report certain foreign properties with a cost greater than $100,000. These requirements, along with the existing requirement to report information on non-arm's length transactions with non-residents were intended to address the concern that income has been inappropriately transferred to tax havens. These requirements are also intended to help Canadians report their world-wide income accurately.

4.39 The Agency has begun to monitor and analyse the information reported in order to conduct risk assessments. Before the Agency can rely on this information and use it to make decisions on compliance programs, it must do more to determine the extent of non-compliance with the foreign reporting requirements. In addition we have noted two multi-billion dollar errors in the information on Canadian foreign investments which Agency officials prepared from one of its foreign-reporting databases. This leads us to question the strengths of the current controls over the completeness and accuracy of the data.

4.40 In December 1997 we were asked by the Governor General in Council to examine the requirement to report specified foreign property over $100,000. In our Report of June 1998, Examination of the Requirements to Report Specified Foreign Property Under Section 233.3 of the *Income Tax Act*, we concluded that the requirement is an appropriate mechanism within an overall strategy to both enhance compliance with the laws that require reporting of foreign-source income, and provide the Agency with information to verify taxpayers' self-assessments.

4.41 We encouraged the Agency to monitor the reporting regime for offshore investments annually. We also suggested the Agency should evaluate after two to three years whether the regime provides the desired information and is meeting its objectives of enhancing compliance with the law without being overly burdensome.

4.42 In January 2002, the Agency completed a review of the requirement to report specified foreign property over $100,000 as part of its overall review of the foreign-reporting requirements. It noted that in 1999, 51,000 taxpayers had completed the required information return. The Agency concluded that the information return is best suited for computer-based risk assessment and currently has limited analytical usefulness. It is considering making changes after discussions with stakeholders.

4.43 **Recommendation.** The Canada Customs and Revenue Agency's ability to assess the international tax risk should be strengthened by

- improving the information and analysis used to assess the overall tax risk from international transactions and types of taxpayers to better determine international audit program guidelines,
- developing a risk assessment model to plan the audit of international issues of large corporations,
- evaluating the international tax risk in all large files that will be audited in a given year before developing the workload of the international auditors,
- using tools to screen for international issues to select small and medium companies for audit, and
- implementing better controls over the integrity of data in the foreign reporting database.

Agency's response. The Canada Customs and Revenue Agency (CCRA) agrees with this recommendation. We will continue to do risk assessment and improve on the risk assessment process already in place.

On September 26, 2002, the Minister of National Revenue reported on CCRA's Future Directions initiative, which includes examining the Agency's approach to large businesses and small and medium enterprises. Through the implementation of this initiative, compliance will be enhanced as greater attention will be focussed on managing the risks of particular clients or client groups.

Work on enhancing our risk assessment framework for international tax issues is underway and will be fully integrated with the existing International Tax Compliance Strategy. This fully integrated risk assessment process, with its ongoing and verifiable risk assessment criteria, will form the basis for directing compliance actions in all areas of international taxation.

Currently, audit resources are allocated to tax services offices based on file complexity, workload populations, groups of taxpayers, and types of transactions in accordance with their perceived international tax risk. CCRA is actively pursuing ways to link information stored in our various databases in order to enhance the assessment of international tax risk.

International issues that are identified through our risk assessment processes are included in the overall large file audit plan and international auditors participate in the initial screening process. Resources are allocated to the files where potential tax risk is a concern. Resource requirements are adjusted as new issues of a higher priority are identified. Therefore, flexibility is essential to the effective delivery of the international audit program.

The risk of each file is assessed at the beginning of a large file audit, and international auditors re-evaluate this risk on an ongoing basis during the audit. We will enhance this process by giving additional training to auditors in order to identify these risks by regions and industry sectors. CCRA will also accelerate its systems-based risk assessment. These measures will assist CCRA in evaluating the overall international tax risk in large files.

CCRA agrees that we should be more vigorous in applying our screening mechanisms to select small and medium companies for international audit. CCRA has initiated a study of the linkage between our International and Small and Medium Enterprises programs to foster cooperation and partnerships and is working to determine, for workload development purposes, systems-based criteria in identifying small and medium companies with potential tax risk relating to international issues.

We will also provide additional program guidance to field auditors on risk assessment of international tax issues and more formalized training sessions to teach all auditors how to properly access and utilize International's different databases.

CCRA is aware of the data integrity issues in an earlier version of one of our foreign-reporting databases. Action had been taken in 1996 to change the foreign-reporting form, and install better validation controls to reduce data-input errors. CCRA will continue to improve the analytical usefulness of the various foreign reporting information returns and ensure complete and accurate information is available to all users.

Audit skills are developing slowly

4.44 In our 1998 Report, Chapter 24, International Tax Directorate: Human Resource Management, we wrote about the difficulties in staffing the international audit positions. Since our last audit, additional international audit staff have been hired. There are currently 238 international audit staff in the tax services offices across the country, with an expansion planned for this fiscal year. In the last four years there has also been a significant number of departures of senior international audit staff to both other audit areas of the Agency and the private sector.

4.45 In some of the tax services offices we visited, over one third of the international audit staff have less than one year's experience and still require some international tax training. As well, some large-file auditors, small and medium business auditors, appeals officers, and the International Tax Directorate staff who have been recruited without previous international tax experience still require basic international-tax training.

4.46 The Agency's internal reports show that last year over 300 people were given the Agency's introductory training course on international tax law. This met over 90 percent of the requests for instruction. However only 13 percent of the requests for 400 places for the advanced course on "Foreign Affiliate and Foreign Accrual Property Income Rules" were satisfied. Twenty nine percent of the requests for instruction on international audit techniques were met. The Agency is shifting its focus on training to on-line learning. However high quality international audit training delivered by experienced practitioners is still needed to improve the competence of the international audit staff.

4.47 Our file reviews and interviews with auditors, team leaders, and section managers indicate that formal training alone does not produce competent international auditors. Strong on-the-job learning with experienced and technically competent team leaders, section heads, or international field advisors is required. This strong technical mentoring is sometimes lacking, most particularly in foreign affiliate issues, since there are few experts in this area across the country or in the International Tax Directorate in Ottawa.

4.48 The range of audit tasks in the international audit sections of a tax services office requires audit skills and technical knowledge in international issues ranging beyond those required for the positions currently classified for this audit function. At the most complex end of large corporate audits, the degree of expertise and experience to identify and audit international transactions in these files is extremely demanding. There are other tasks that could more appropriately use more junior level staff than are currently available. Having a broader range of audit positions in most tax services offices would also assist in international auditor development and possibly assist with auditor retention. Addressing this concern is within the mandate of the International Tax Programs Task Force, which was created within the Agency in April 2001.

4.49 The current staffing and the level of training activities may not be able to address the economic and labour force realities in some communities. In the Metro Toronto tax services offices there has been a shortage of experienced international auditors for some time. An internal report shows that these are the same offices that are responsible for the audit of the large Canadian companies which report nearly 40 percent of all foreign affiliates. The Agency needs to look for new ways to undertake the complex international audits of large corporations that file in these tax services offices in a more timely and effective manner. We have observed international auditors from one tax services office assisting another tax services office where experienced international auditors were not available to undertake an audit.

4.50 **Recommendation.** The International Tax Directorate and the tax services offices should seek ways to improve the international audit program's human resources capability at a faster rate and explore ways to ensure that complex international audits are completed by experienced international auditors.

Agency's response. The Canada Customs and Revenue Agency (CCRA) agrees with this recommendation and will continue to provide training to all staff involved with international tax audits. CCRA recognizes the benefits of a well-trained staff, and new training courses and innovative learning tools are being developed to supplement those that currently exist.

In addition, mentoring is encouraged and our headquarters staff regularly visits tax services offices to discuss cases and provide technical support to the international auditors, team leaders and managers.

As well, the International Tax Programs Task Force was created in April 2001 to review the workload in tax services offices, the appropriate organizational structure to address the workload, and the personnel required to deliver international tax programs. The goal is to provide for an integrated workflow that maximizes efficiency and effectiveness. Senior management is in the process of finalizing the recommendations of the Task Force.

CCRA continues to staff positions as expeditiously, efficiently and cost-effectively as possible to meet its operational objectives, at the same time exploring new alternatives and improving those aspects of planning and staffing processes that are under its control to ensure complex international audits are completed by, or guided by experienced international auditors.

CCRA will increase its international tax research abilities, auditor expertise, and training capabilities in the highly complex areas of transfer pricing, foreign affiliates, and offshore trusts.

Audit management must be strengthened

4.51 In our review of audit files with significant transfer pricing and investment income issues, we found that often an excessive amount of time had elapsed from the beginning to the end of the audit of these issues. It was not uncommon to find audits that took more than three years to complete. We found that often delays in file progress can be attributed to the following aspects of international audit management.

Obtaining foreign-based information from taxpayers in a timely way is essential

4.52 Audit files show that international auditors experience difficulties in getting requested documents, and answers to their queries from taxpayers. Taxpayers often claim that the required documents are kept outside the country, and are unavailable, or are covered by secrecy provisions of the foreign jurisdictions. Many of the audits of large corporations we reviewed were done under an agreement signed by the taxpayer, which defined response times for providing information. In these cases, the time that the taxpayer took to provide information was much longer than agreed. We have observed cases where answers to queries are incomplete after a year. It is therefore important that

- the information requested from taxpayers be as precise as possible,
- auditors actively pursue outstanding requests for information,

- auditors review all the requested information for completeness as soon as possible after being received, and
- the Agency take available measures to obtain foreign-based information.

Our reviews of audit files as well as the Agency's own quality review studies show that these measures had not been taken in a large number of audits.

4.53 We have observed that the exchange of information provisions under the tax treaties, which Canada has signed, with 75 countries have not been used frequently. Auditors generally request the information directly from the taxpayer but often did not receive the needed information. A request for information from a treaty partner according to the terms of the treaty generally was not issued when taxpayers did not reply.

4.54 In the audits we reviewed we did not find that any requirements had been issued to taxpayers to produce foreign-based information. Interviews with auditors indicated that they believe that the agreements entered into with taxpayers do not allow the Agency to issue a formal demand to provide information. More timely action to formalize requirements that taxpayers produce information related to offshore transactions would permit audits to move forward.

4.55 One of the underlying reasons for audit delays in the past may have been that experienced economists were not available to give input on audits that involved transfer-pricing issues. In many cases, the auditors did not request an economist's help until late in the audit process. This often resulted in a new series of queries to the taxpayer, adding to the delay.

4.56 Information for a transfer-pricing audit is gathered by the international auditor in the tax services office before the economist's input can be made. However, auditors and economists together can best decide on the specific information needed from the taxpayer early on in the audit. To reduce the time needed to complete audits, transfer-pricing audits must be referred to the economists earlier in the audit process, and economists must work in closer collaboration with the international auditors.

Good global business knowledge is important

4.57 Every auditor we spoke to confirmed that the key to a successful international audit is having a good understanding of how a business organizes its operations on a worldwide basis. Further discussion with auditors and our review of audit files revealed that international auditors often need to get this information from other sources within the Agency. They do not often seek the input of industry specialists when planning and carrying out their audits. We also saw audit delays as a result of the inability of the international auditor to evaluate information provided by taxpayers on their international business operations.

4.58 The position of industry specialists requires individuals that have developed an understanding of the context in which corporations operate in a specific sector, and thus are able to provide information to help international auditors better target their audit procedures and questions. Through discussions with participants and a review of the agenda and presentations, we have seen the value of the national sector-based conferences, in particular the national banking conference, which was organized by Industry Specialists Services and included international compliance issues.

4.59 However some of the business questions arising from the international audits of specific transfer pricing and investment income issues may be beyond even the expertise of the industry specialists. While the national conferences and industry-specific issue lists provided by Industry Specialists Services are positive initiatives in that they include international issues, there is still a need to provide international auditors with better information on sector-specific business issues in a global context, in order to facilitate the audit process.

4.60 **Recommendation.** The Canada Customs and Revenue Agency should strengthen aspects of its management and support of international audits by

- formalizing requirements and requests to produce information related to offshore transactions,
- involving economists earlier in the audit process and having them work in closer collaboration with the international auditors, and
- providing international auditors with better information on global sector-specific business issues.

Agency's response. The Canada Customs and Revenue Agency (CCRA) agrees with this recommendation.

Where the auditor believes that the taxpayer has or ought to have documentation relating to offshore transactions, and such documentation is not provided by the taxpayer, requirements should be used to obtain the requested documentation. CCRA has already initiated a process of obtaining input from various areas of the Agency and the Department of Justice to facilitate the usage of formal requirements.

We will continue to emphasize in training sessions provided to all staff involved with international tax audits the importance of formalizing requirements that taxpayers produce information related to offshore transactions.

Also, CCRA will continue to encourage international auditors to request the input of an economist as early as possible in the audits of complex transfer pricing transactions. Presentations have been made to field staff on a regular basis regarding the role of the economist. More timely guidance from the economists so the appropriate information will be requested from taxpayers early in the audit can be expedited with an increase in economist resources.

CCRA recognizes that international auditors in the field and economists in headquarters need to have all the necessary information on global sector-specific business issues on audits being undertaken. CCRA will ensure there is an efficient sharing of knowledge among its specialists, including any specialized industry knowledge affecting international issues. Specialists in CCRA also participate in various international fora. The sharing of this global sector-specific business knowledge among different areas of CCRA, including international auditors in the field, will result in a more successful international audit.

Management information for program planning

4.61 The Agency collects information on the number of hours spent auditing international tax issues, the number of cases completed and the expected tax recovery. This information along with other indicators are used to measure the performance of the international audit program. A three-year historical average of direct hours and recoveries per case are also used to determine the expected number of cases to be completed in the future and resulting tax recoveries for a given level of staffing.

4.62 A "case" is used as the basic unit of measurement of performance. Direct audit hours and tax reassessments are recorded for each case. When auditing large companies and their associated corporations, a case was opened for every year audited and for every associated corporation audited. The audit of large corporations covered one to five years. As a result, one audit of the international transactions of a large corporation can be reported as several cases.

4.63 International auditors open an additional case to continue recording international audit activities if domestic auditors close their case before the audit of the international issues is finished. The tax services offices have developed different practices to record the continuation of the audit of the international issues.

4.64 As a result of these practices the number of cases completed in a year is significantly larger than the number of actual audits completed. For 2000–01, the International Tax Directorate reports completing 360 cases where international auditors have audited the international transactions of large corporations. We estimate that this represents about 270 actual audits.

4.65 These methods of counting the number of cases results in the International Tax Directorate not having correct information on the number of hours needed to complete an audit and the tax reassessment resulting from the audit. Better performance information could be used to develop guidelines on the direct hours needed to complete audits of differing sizes and complexity. This would give management more meaningful information on which to make decisions when allocating resources to international audits.

4.66 We observed other deficiencies in the information.

- Currently many domestic auditors record their time to domestic audit activities while auditing international issues. The total hours spent auditing international issues should be recorded regardless of whether the work is done by an international audit specialist or a domestic auditor.
- International Tax Directorate specialists and economists do not record direct hours spent on cases.

- Auditors do not always report the description of the income and tax changes they have made accurately. Management uses this information to determine which areas of non-compliance are most subject to changes.

4.67 **Recommendation.** The Canada Customs and Revenue Agency should gather better information about the time needed to actually complete audits of the international transactions of large corporations and the result of those audits.

Agency's response. The Canada Customs and Revenue Agency (CCRA) agrees with this recommendation and will continue to examine ways to enhance reporting of time spent on international tax activities to ensure it is complete and accurate. Guidance for the field on case management is under development and will clarify certain issues relating to the definition of a "case" in order to assist international auditors to report their time spent more accurately.

CCRA agrees that tighter controls need to be exercised when information is being entered in the Agency's systems. CCRA will ensure that reconciliations are done on a regular basis with respect to income and tax changes processed on reassessment between its main reporting system and its supplementary system.

Conclusion

4.68 Better assessment of the risk of taxpayers not complying with the tax rules on international transactions is needed to determine what compliance work should be undertaken in order to provide an adequate check on the assessment of tax revenue. The International Tax Directorate and other areas of the Compliance Programs Branch could reduce the time over which audits of international issues are completed by strengthening their ability to provide advice on international business practice and economic analysis earlier in the audit process. The international audit program needs better information on the resources used to complete the audit of international issues, the tax reassessed, and the issues identified in reassessments to determine its future resource requirements and program directions.

4.69 The Agency must find ways to improve the international audit program's human resource capability at a faster rate, and explore ways to ensure that complex international audits are completed. In the Toronto area where 40 percent of large corporations file their tax returns, economic conditions have made recruiting and retaining international auditors difficult. The current staffing and level of training activities may not be able to address this problem. In some tax services offices over one-third of the international audit staff have less than one year's experience, and still require some training. Other staff, including some auditors of large corporations and auditors of small and medium businesses who were recruited without previous international tax experience still require basic international tax training.

About the Audit

Objective

The objective of the audit was to determine whether Canada Customs and Revenue Agency's current procedures provide for an adequate check of the assessment of tax revenues from the international transactions of Canadian residents.

Scope and approach

The audit focussed on the activities within the Agency to foster compliance with the sections of the *Income Tax Act* covering the international transactions of Canadian residents. There are specific rules that deal with the taxation of foreign transactions of Canadian residents. For example, transfers of goods and services between related parties must take place at arm's length prices. The foreign affiliate rules and the foreign accrual property income rules of the Canadian *Income Tax* Act deal with dividends and other income from investments in foreign entities.

We reviewed the International Tax Directorate's plan for managing international tax risk and audit operations. We paid particular attention to the activities of the International Tax Operations Division in the Directorate's headquarters in Ottawa and of the International Audit Section in selected tax services offices. We selected and reviewed audit files, interviewed Agency management and staff, and analysed performance data on the results of audits of international transactions of Canadians. We focussed on compliance activities directed at Canada's largest corporations and the relationship that exists between the international audit specialists and the auditors of large corporations who co-ordinate their activities. We also looked at the support provided by head office to international audit activities, and the strategic advice and direction provided on risk assessment, and development of a [illegible] compliance approach. We also discussed international audit operations and policies with the private sector.

Criteria

Our audit was based on the following criteria.

- The Agency would assess the tax risks associated with Canadian taxpayer compliance with the Canadian income tax rules related to international transactions and implement a compliance strategy to effectively manage these risks.
- The Agency would have the capacity (resources and systems) to satisfactorily carry out its international compliance activities.
- The International Tax Directorate would provide timely functional guidance and assistance to international operations in the tax services offices.
- The Agency would have accurate information on the nature and extent of its international compliance activities.

Audit team

Assistant Auditor General: Douglas Timmins
Principal: Barry Elkin
Directors: Brenda Siegel and Denis Labelle

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Related audit work

See also Chapter 11, Other Audit Observations, Department of Finance: Tax arrangements for foreign affiliates have eroded Canadian tax revenues of hundreds of millions of dollars over the last ten years.

Report of the Auditor General of Canada to the House of Commons—December 2002

Main Table of Contents

Matters of Special Importance—2002
Foreword and Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada-Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada-Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

Appendices

2002

Report of the
Auditor General of Canada
to the House of Commons

DECEMBER

Chapter 5
Financial Management and Control in the Government of Canada

Office of the Auditor General of Canada

The December 2002 Report of the Auditor General of Canada comprises 11 chapters, Matters of Special Importance—2002, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

Ce document est également disponible en français.

© Minister of Public Works and Government Services Canada 2002
Cat. No. FA1-2002/2-13E
ISBN 0-662-33111-7

Chapter

5

Financial Management and Control in the Government of Canada

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

Table of Contents

Main Points 1

Introduction 3

Financial management and control is vital for achieving results for Canadians 3
The government has initiatives that address financial management and control 4
Focus of the chapter 5

Observations and Recommendations 7

Some progress achieved 7

More progress needed 7

Departments need to strengthen their internal control systems 7
Departments need to improve the quality of their financial information 9
The study of accrual-based budgeting and appropriations needs to be completed 12
Issues delaying accrual accounting for government financial statements need to be resolved 13

Leadership, skills, and support 17

Central leadership and support are needed 18
Departmental leadership and skills are needed 20

Conclusion 22

About the Chapter 24

Appendix

Accrual accounting 25

Financial Management and Control in the Government of Canada

Main Points

5.1 Financial management reform has been an elusive goal in the Government of Canada for over 40 years. There has been recent progress in this area, including the implementation of accrual accounting policies in departments and the development of guidance to implement modern comptrollership. Nevertheless, more progress is needed to make financial management and control in the government a reality.

5.2 The government has not significantly advanced its study of accrual-based budgeting and appropriations. The Treasury Board Secretariat continues to state that this complex issue requires extensive study before a decision can be made, even though the issue has been under examination for some time. In our view, resolution of this matter is needed to help make financial management and control in the government effective.

5.3 As of 1 April 2001, all departments and agencies have successfully implemented new financial systems capable of handling accrual financial information and submitting that information to the government's central systems for preparation of the summary financial statements. As we stated in our previous reports to Parliament, departments and agencies now need to improve the quality of their financial information that supports both departmental financial reporting and analysis and, ultimately, the preparation of the government's summary financial statements. They also need to ensure that appropriate internal controls are in place for their financial accounting and information systems.

5.4 The government's current model for departmental financial statements does not require recording and disclosure of some significant costs and liabilities. In our view, without this information, the financial statements do not provide accurate and reliable information on departments' program costs and financial positions. We encourage the government to resolve the outstanding concerns about departmental financial statements and to establish a target date for finalizing auditable departmental financial statements.

5.5 Financial management and control is vital for achieving results for Canadians. It involves the use of financial and non-financial information in decision making, and the effective implementation of financial information systems and controls. The Office of the Auditor General of Canada fully supports the government's implementation of improved financial management and control practices, including the adoption of full accrual accounting.

5.6 However, making financial management and control in government more effective involves more than simply preparing financial information or implementing financial systems. A change in the way financial information is used must occur at all levels within the government to ensure that financial management and control is an integral part of government operations and decision making.

5.7 The Comptroller General of Canada needs to lead this change by

- building on the momentum created by the importance and priority assigned to the Comptrollership Modernization Initiative by the Clerk of the Privy Council,
- aggressively advancing financial management and control within government so that the environment for change can be improved, and
- developing a strategy to increase the representation of professional accountants in the positions of senior financial officer and senior full-time financial officer.

Background and other observations

5.8 Accrual accounting refers to an underlying basis of accounting used to record the financial transactions of an entity. Accrual accounting recognizes transactions and other events when they occur, rather than when cash or its equivalent is received or paid. Expenses are recorded in the period when the goods or services are consumed, revenues are recorded in the period to which they pertain, and the multi-year benefits associated with long-lived assets are matched to the time when they are expected to be used.

5.9 Accrual financial information helps users appreciate the full scope of government—the resources, obligations, financing, costs, and impacts of its activities, including the costs of consuming assets over time. This more complete picture enables legislators to hold the government more accountable for the stewardship of its assets, the full costs of its programs, and its ability to meet short-term and long-term financial obligations.

5.10 Accrual financial information can also help improve decision making within departments. Managers will improve their focus on the stewardship of assets and liabilities under their control, consider the full costs of providing services, and examine how the full range of costs might affect their use of public funds.

5.11 In the 2001 Budget, the government stated that it had decided to delay implementation of full accrual accounting for its summary financial statements for at least one year. The government made this decision because accrual financial information was not available to allow consideration of the impact of implementation on the Budget, and because important components of the information required for implementing full accrual accounting had not been verified and audited. We encourage the government to resolve concerns that are causing delays in introducing full accrual accounting for its summary financial statements, including the processes for determining management estimates, and to implement it for the year ending 31 March 2003.

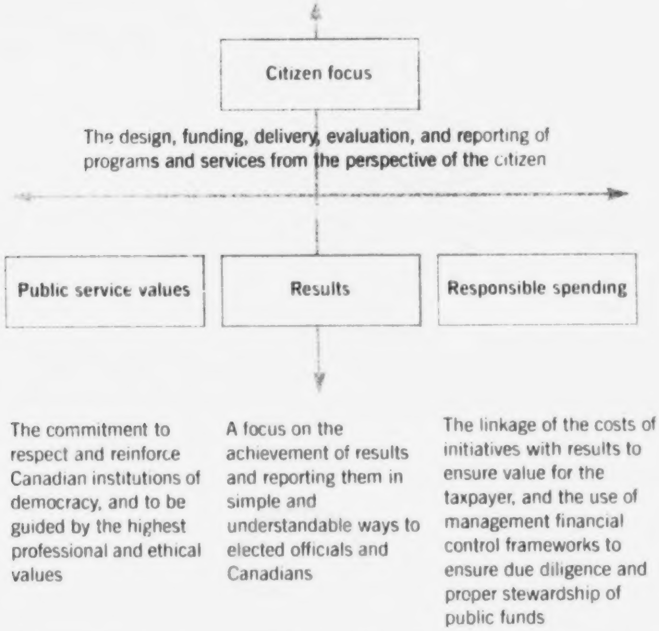
The Treasury Board Secretariat has responded. The Secretariat has indicated the actions it has taken or intends to take to address the recommendations. Its detailed response follows each recommendation throughout the chapter.

Introduction

Financial management and control is vital for achieving results for Canadians

5.12 In *Results for Canadians: A Management Framework for the Government of Canada* (March 2000), the Treasury Board Secretariat outlined its framework for effective management, based on four key commitments: citizen focus, public service values, results, and responsible spending (Exhibit 5.1).

Exhibit 5.1 Results for Canadians: Four management commitments


Citizen focus
The design, funding, delivery, evaluation, and reporting of programs and services from the perspective of the citizen
Public service values
Results
Responsible spending
The commitment to respect and reinforce Canadian institutions of democracy, and to be guided by the highest professional and ethical values
A focus on the achievement of results and reporting them in simple and understandable ways to elected officials and Canadians
The linkage of the costs of initiatives with results to ensure value for the taxpayer, and the use of management financial control frameworks to ensure due diligence and proper stewardship of public funds

Source: Treasury Board Secretariat. Adapted from *Results for Canadians: A Management Framework for the Government of Canada*

5.13 *Results for Canadians* also noted that responsible spending is both a departmental and a government-wide commitment. At both levels, it is essential to measure and evaluate results in order to deliver high-quality programs and services.

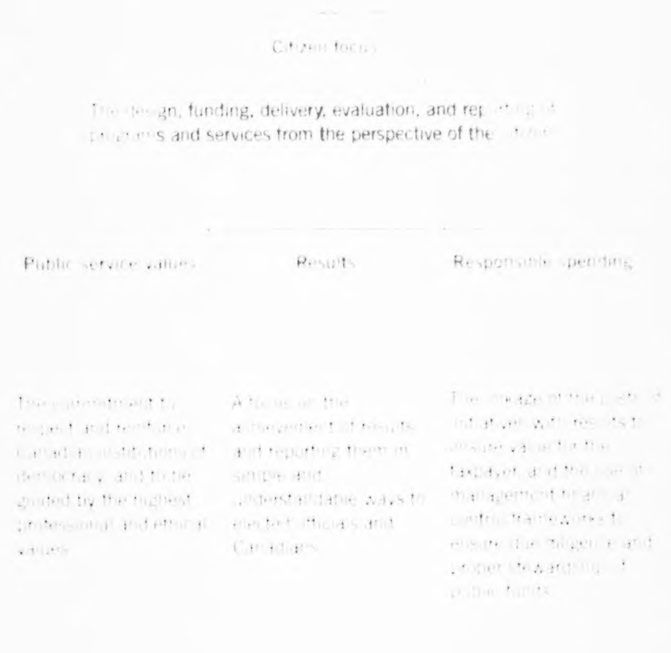
5.14 Accordingly, the document states that departments and agencies need to measure, evaluate, and report on key aspects of programs and their performance in core areas; hold managers accountable for achieving results; and ensure unbiased analysis of performance. Further, departments need to produce information on program costs so that they can allocate resources and restructure programs in response to changing needs and priorities. They need to integrate financial and non-financial performance information, enabling them to link costs with actual or expected results. They also need to effectively manage risk and establish a proper environment of control.

Introduction

Financial management and control is vital for achieving results for Canadians

5.12 [illegible]

Exhibit 5.1 Results for Canadians: Four management commitments



Citizen focus

The design, funding, delivery, evaluation, and reporting of programs and services from the perspective of the citizen.

Public service values

The commitment to respect and reinforce Canadian institutions of democracy, and to be guided by the highest professional and ethical values.

Results

A focus on the achievement of results and reporting them in simple and understandable ways to elected officials and Canadians.

Responsible spending

The linkage of the cost of initiatives with results to ensure value for the taxpayer, and the use of management and control frameworks to ensure due diligence and proper stewardship of public funds.

5.13 [illegible]

5.14 [illegible]

5.15 At the government-wide level, officials need to gather integrated, cross-departmental information on expenses and results. This information will make it possible to assess overall performance against policies and priorities, manage overall risk, and identify opportunities for efficiency.

The government has initiatives that address financial management and control

5.16 The Treasury Board Secretariat has a medium-term agenda for management change to ensure a successful shift within the government toward responsible spending. The initiatives for change include the following:

- Citizen-centred Service Delivery
- Government of Canada On-line
- Modern Comptrollership
- Improved Reporting to Parliament
- Program Integrity
- Developing an Exemplary Workplace

5.17 Of particular importance is the Comptrollership Modernization Initiative and its emphasis on financial management and control. The Secretariat started the Initiative to strengthen management capabilities in departments and agencies. The Initiative is an effort to develop standards and practices for integrating financial and non-financial performance information into a meaningful whole and communicating that information to those who need it, properly assessing and managing risk, and ensuring appropriate control systems. It also seeks to improve procurement, management of real property, asset management, and other program and financial management activities. Modern comptrollership involves all managers, not only financial officers, and is an important part of every management activity. The Initiative goes to the heart of modern management and the achievement of results for Canadians.

5.18 The Treasury Board Secretariat introduced its Financial Information Strategy (FIS) to facilitate the meaningful use of financial data, including accrual accounting information (see the Appendix). Now part of modern comptrollership, the Strategy allows costs to be more closely linked with activities, operations, and results. It is an essential building block of integrated performance information, stewardship, and accountability.

5.19 The revitalized Financial Information Strategy had three objectives:

- Departments and agencies would select one of seven systems approved by the Treasury Board Secretariat and implement new financial systems that would support the full accrual method of recording and reporting financial transactions.
- The government would develop new accounting policies that comply with generally accepted accounting principles for the public sector. Departments and agencies would apply those policies and take primary responsibility for the quality and completeness of detailed information. They would produce annual financial statements that can be audited.
- Government managers would have access to better financial information and use it in their day-to-day decision making.

5.20 In *Managing for Results 2000*, the President of the Treasury Board stated that the government would introduce full accrual accounting for the *Public Accounts of Canada* in 2001–02. This final major step in improving financial information would incorporate accrual-based budgeting and financial statements.

Focus of the chapter

5.21 Financial management and control has been a long-standing concern of the Office of the Auditor General of Canada. The Office has carried out a number of recent audits that have monitored the government's progress toward achieving modern comptrollership and implementing the Financial Information Strategy (Exhibit 5.2).

Exhibit 5.2 Our recent reports on financial management and control

Year	Observations and recommendations
1999	**November Report, Chapter 21, Financial Information Strategy: Departmental Readiness** The government has not yet taken the necessary steps to get support for the Financial Information Strategy (FIS) from deputy ministers and senior management. With less than two years until the target date, we urge the government to "turn up the heat" and spur departments to accelerate their activity.
2000	**October Report, Chapter 13, Assessment of Financial Management Capabilities in Departments** From an assessment of financial management capabilities in five departments, the most significant challenge has been to institutionalize a strong appreciation of the role that financial management can and should play in day-to-day decision making.
2001	**December Report, Chapter 1, Financial Information Strategy: Infrastructure Readiness** Departments have successfully implemented the necessary FIS infrastructure but need to stabilize their systems and ensure that appropriate controls are in place. The government has also developed the necessary accrual accounting policies, but departments are at various stages of implementing those policies and the government has made slow progress toward deciding on an approach to accrual-based budgeting and appropriations. In summary, the government has accomplished a lot but still has much work to finish and should not be too quick to declare FIS a victory.
2002	**April Report, Chapter 7, Strategies to Implement Modern Comptrollership** The adequacy of the strategies and plans to implement modern comptrollership in seven departments was assessed and only three of the seven departments were found to have established comprehensive strategies and plans. Departments also need to establish clear target dates and indicators for modern comptrollership and to improve managers' understanding of the initiative.

5.20 [illegible]

Focus of the chapter

5.21 [illegible]

Exhibit 5.2 Our recent reports on financial management and control

Year	Observations and recommendations
1999	**November Report, Chapter 21, Financial Information Strategy: Departmental Readiness** The government has not yet taken the necessary steps to get support for the Financial Information Strategy (FIS) from deputy ministers and senior management. With less than two years until the target date, we urge the government to "ramp up the heat" and push departments to accelerate their activity.
2000	**October Report, Chapter 13, Assessment of Financial Management Capabilities in Departments** From an assessment of [illegible] departments, the most significant [illegible] has been found [illegible] strong appreciation of the [illegible] should play in day to day decision [illegible]
2001	**December Report, Chapter 1, Financial Information Strategy: Infrastructure Readiness** Departments have successfully implemented the necessary FIS infrastructure but need to stabilize their systems and ensure that appropriate controls are in place. The government has also developed the necessary accrual accounting policies, but departments are at various stages of implementing these policies and the government has made slow progress toward deciding on an approach to accrual-based budgeting and appropriations. In summary, the government has accomplished a lot but still has much work to do and it should not be too quick to declare FIS a victory.
2002	**April Report, Chapter 7, Strategies to Implement Modern Comptrollership** The adequacy of the strategies and plans to implement modern comptrollership in seven departments was assessed and only three of the seven departments were found to have established comprehensive strategies and plans. Departments also need to establish clear target dates and indicators for modern comptrollership and to improve managers' understanding of the initiative.

5.22 There have been calls for financial reform in the government for almost 40 years (Exhibit 5.3). Although the importance of these recommendations [illegible] recommendations have [illegible] into [illegible] [illegible] over the [illegible] [illegible].

Exhibit 5.3 Previous calls for financial reform

Year	Recommendation
1962	**Royal Commission on Government Organization (Glassco Commission)** "An accounting system, capable of facilitating decision making by management, should provide *complete* costs of activities." Such a system will then lead to improved decision making.
1979	**Royal Commission on Financial Management and Accountability (Lambert Commission)** "Comprehensive cost-based accounting systems should be developed and used in all federal departments and agencies, and these systems should meet the criteria of capturing *all* costs on a timely and accurate basis and be integrated with costing systems capable of analyzing the data thus obtained."
1987	**Office of the Auditor General, Financial Management and Control Study** Current information for managers tells them where they stand in relation to their budget, but not the cost effectiveness of their operations. Although operational data are available, they can rarely be related to financial data so as to determine the costs of specific operations. The concept underlying financial management is that objectives, results, and resources should be linked.
1997	**Independent Review Panel on Modernization of Comptrollership in the Government of Canada** "The Panel believes modern comptrollership is about ensuring that management decision making has the benefit of rigorous, complete and integrated financial and non-financial, historical and prospective performance information as well as appropriate advice, analysis and interpretation of this information."

5.23 In this chapter, we examined the government's progress in implementing accrual-based budgeting and accrual financial information systems. We sought answers to the following questions: What is the current status of accrual financial information and its availability? Are the necessary information systems designed to produce such information in place and part of an overall control framework that will meet the needs of financial management? We also wanted to know what the government has decided about accrual budgeting and appropriations.

5.24 In our approach, we relied on the nature, scope, and extent of our audit of the summary financial statements of the Government of Canada. We derived our observations and findings from the work done in that audit as well as other audits conducted by the Office of the Auditor General of Canada in this area.

5.22 There have been calls for financial reform in the government for almost 40 years (Exhibit 5.3). Although the importance of the issue is widely recognized, we are disappointed that more progress has not been made in this area.

Exhibit 5.3 Previous calls for financial reform

Year	Recommendation
1962	**Royal Commission on Government Organization (Glassco Commission)** "An accounting system, capable of facilitating decision making by management, should provide *complete costs* of activities." Such a system will then lead to improved decision making.
1979	**Royal Commission on Financial Management and Accountability (Lambert Commission)** "Comprehensive cost-based accounting systems should be developed and used in all federal departments and agencies, and these systems should meet the criteria of capturing *all costs* on a timely and accurate basis and be integrated with costing systems capable of analyzing the data thus obtained."
1987	**Office of the Auditor General, Financial Management and Control Study** Current information for managers tells them where they stand in relation to their budget, but not the cost effectiveness of their operations. Although operational data are available, they can rarely be related to financial data so as to determine the costs of specific operations. The concept underlying financial management is that objectives, results, and resources should be linked.
1997	**Independent Review Panel on Modernization of Comptrollership in the Government of Canada** "The Panel believes modern comptrollership is about ensuring that management decision making has the benefit of rigorous, complete and integrated financial and non-financial, historical and prospective performance information as well as appropriate advice, analysis and interpretation of this information."

5.23 In this chapter, we examined the government's progress in implementing accrual accounting and related financial information systems. We sought answers to the following questions: What is the current status of accrual financial information and is it credible? Are the financial information systems designed to produce such information integrated into an overall control framework that will yield reliable accrual financial information? We also wanted to know what the government had decided to do about accrual budgeting and appropriations.

5.24 In our approach, we relied on the nature, scope, and extent of our audit of the summary financial statements of the Government of Canada. We derived our observations and findings from the work done in that audit as well as other audits conducted by the Office of the Auditor General of Canada in this area.

5.25 As a result, this chapter is not an audit of financial management and control in government. Rather it is an account of our observations arising from the audit of the government's summary financial statements and from other audit work done by our Office and that we believe are important for improving financial management and control in government. Further details on our objectives, scope, and approach can be found at the end of the chapter in About the Chapter.

Observations and Recommendations

Some progress achieved

5.26 In recent years, the government has begun to make progress in advancing financial management and control practices. Among the achievements are the following:

- The Treasury Board Secretariat has developed a series of accounting policies for accrual accounting, and departments have implemented those policies.
- The Secretariat has established a strategy for the next phase of the Comptrollership Modernization Initiative and has issued guidance to departments and agencies on preparing plans for implementation of the initiative.
- Departments have completed self-assessments on their capacity for modern comptrollership and have prepared implementation plans in response to their findings.
- As of 1 April 2001, all departments and agencies have successfully implemented one of the Secretariat's recommended information systems supporting accrual accounting.
- For 2002–03, the Clerk of the Privy Council Office's Deputy Minister performance agreements have made modern comptrollership a priority.

5.27 The Office of the Auditor General of Canada recognizes these achievements and fully supports the government's plans and strategies for improving financial management practices in government, including the implementation of financial information systems and accrual accounting.

More progress needed

5.28 The government has expended considerable time, money, and effort in improving financial management practices. As a result, prior to our audit of the summary financial statements of the Government of Canada, we had expected to observe considerable improvement in the preparation of financial information, as well as in the implementation and use of the related financial information systems. What we actually observed, however, was that financial management and control in the government still needs significant improvement.

Departments need to strengthen their internal control systems

5.29 In our December 2001 Report, Chapter 1, Financial Information Strategy: Infrastructure Readiness, we evaluated the controls governing selected computer information systems, along with the related management and monitoring controls, in three departments and agencies. In the past year, we continued our review of these controls in five departments and agencies and in the government's Regional Pay System (Exhibit 5.4).

Exhibit 5.4 Overview of controls assessments

Objective

We sought to assess the quality of controls in selected financial information systems. We wanted to determine the extent to which the controls of various departments were sufficient to ensure that financial information was accurate, complete, and properly authorized.

Scope

We selected two departments and one agency in 2001[1], and four departments, one agency, and the government's Regional Pay System in 2002[2]. Each ranked among the largest departments and agencies, and was using one of the approved systems under the shared systems initiative.

Methodology

We documented our understanding of the various controls in the selected departments and agencies and identified and tested key controls (those responsible for preventing or detecting errors in financial information).

Conclusion

With the exception of the government's Regional Pay System (see Exhibit 5.5), we found that the controls did not meet the requirements. Departments, however, have been receptive to our recommendations. With proper attention, in most cases the problems can be solved within a reasonable period of time.

Notes: [1] Canadian Heritage, Agriculture and Agri-Food Canada, and the Canada Customs and Revenue Agency (expenditure systems).

[2] Fisheries and Oceans Canada, Public Works and Government Services Canada, Indian and Northern Affairs Canada, Department of Foreign Affairs and International Trade, the Canada Customs and Revenue Agency (revenue ledger systems), and the government's Regional Pay System.

5.30 With the exception of the government's Regional Pay System (Exhibit 5.5), the significant challenges that we previously identified in our 2001 Report, Chapter 1 remain (see Controls for financial information systems—challenges remain, page 10).

5.31 The challenges that we have identified are not insurmountable. With attention, most problems could be solved within a reasonable period of time. Many departments have already taken positive steps to respond to these issues. Doing so represents an opportunity for the departments to considerably strengthen their overall control systems. Systems-based controls can generally be applied more systematically and comprehensively than manually based controls. For this reason, they are preferred.

5.32 Departments also need to request that their internal audit function provide assurance on their financial accounting and related systems. The revised Treasury Board Policy on Internal Audit repositions the role of internal audit as a provider of assurance, including assurance of the completeness and accuracy of information for decision making and reporting.

Exhibit 5.5 The Regional Pay System—Controls assessment

Civilian personnel costs for the Government of Canada are about $14 billion annually. Public Works and Government Services Canada (PWGSC) processes the government's payroll through its Regional Pay System. Departments and agencies maintain the central payroll master files used by the system to produce the biweekly payroll. PWGSC has incorporated key controls directly into the system, including authorities, edits, exception reports, reconciliations of control accounts, and segregation of duties. It has also implemented a structured program change management process that includes needs identification, program testing, and user acceptance prior to release into production. Departments maintain controls for the input, edit, and authorization of changes to the payroll master file by segregating duties surrounding data entry and verification and by ensuring that all errors are resolved. In addition, management and monitoring controls (such as comparing budgeted to actual expenditures, reviewing error analysis reports, and performing ratio analysis) are carried out by both PWGSC and departments to ensure the timeliness, accuracy, and completeness of payroll processing. On the basis of this assessment of the Regional Pay System control framework, we concluded that the controls met the objectives of the controls assessment.

This approach would strengthen the integrity of financial information within departments and help ensure the integrity of systems and information shared across the government.

5.33 **Recommendation.** The Treasury Board Secretariat should ensure that departments have established target dates and plans, including assurance from departmental internal audit groups, to address the internal control challenges in their financial accounting and information systems.

Treasury Board Secretariat's response. The Treasury Board Secretariat is leading several working groups to assist departments in the evolution of control frameworks surrounding their financial accounting and information systems. Certain of these groups deal separately with departmental financial statements, the classification and coding of financial transactions, system-related issues and internal audit. Each of these groups is working on a consultative basis to address issues on the basis of risk.

Departments need to improve the quality of their financial information

5.34 In our audit of the government's summary financial statements, we found that many departments were experiencing problems with the quality of their financial information. Some of the problems were identified by the Receiver General function of Public Works and Government Services Canada, which regularly reviews summary information submitted by departments in fulfilling its responsibility for the accuracy and completeness of the government's central financial management reporting system. The Receiver General's quality control review has typically found the following:

- invalid combinations of financial accounts and appropriation codes;
- invalid use of restricted reporting codes;
- invalid use of selected appropriation references; and
- financial accounts with improper balances.

[illegible] 2 Overview of [illegible]

Objective

[illegible]

Scope

[illegible]

Methodology

[illegible]

Conclusion

[illegible]

Exhibit 5.5 The Regional Pay System — Controls assessment

Payroll personnel costs for the Government of Canada amounted to $[illegible] billion [illegible] Public Works and Government Services Canada (PWGSC) processes the government payroll through its Regional Pay System. Departments and agencies are [illegible] the central payroll master file used by the system to [illegible] the biweekly payroll. PWGSC [illegible] key controls [illegible] the system [illegible] It has also implemented a structured program [illegible] program testing [illegible] production. Departments [illegible] changes to the payroll master file [illegible] PWGSC and departments [illegible] On the basis of the assessment of the Regional Pay System [illegible] assessment.

[illegible] Recommendation.

Treasury Board Secretariat's response.

Departments need to improve the quality of their financial information

5.54 [illegible]

- [illegible]
- [illegible]
- [illegible]
- [illegible]

Controls for financial information systems—challenges remain

- **Manual processing controls.** Control frameworks do not appropriately integrate manual processing controls within the new electronic control environment. Key processing controls for purchasing, payment, and confirmation of receipt of goods and services are performed outside the information systems environment. Manual controls are less systematic and less comprehensive in their application than electronic controls. They can also be more easily circumvented, presenting the potential for error or fraud through incomplete, inaccurate, or unauthorized activity.
- **Electronic security controls.** Electronic security controls are not well managed. The primary control mechanism in many of the new systems is the management and control of user access rights and privileges. We found that too many individuals are provided broad system access or that individuals are given permission to perform certain functions incompatible with their other roles and responsibilities. Consequently, information could be lost or corrupted.
- **Monitoring controls.** Monitoring controls require substantial improvement. These controls are an integral part of any control framework because they engage senior management in analyzing the reasonableness of results. Without sufficient monitoring controls, data accuracy and validity may be compromised and misstatements or unauthorized expenditures may result. Management needs to do more than simply compare actual results with established budgets [illegible] organization units. Such basic forms of review often fail to identify errors that have occurred but that are masked because expenses are within budget. [illegible] attention needs to be given to key financial performance measures [illegible] the review of [illegible] and suspense accounts, the review of [illegible] selected grant and contribution payments, the review of [illegible] and the performance of [illegible].
- **New financial systems.** [illegible]

Controls for financial information systems—challenges remain

- **Manual processing controls.** Control frameworks do not appropriately integrate manual processing controls within the new electronic control environment. Key processing controls for purchasing, payment, and confirmation of receipt of goods and services are performed outside the information systems environment. Manual controls are less systematic and less comprehensive in their application than electronic controls. They can also be more easily circumvented, presenting the potential for error or fraud through incomplete, inaccurate, or unauthorized activity.

- **Electronic security controls.** Electronic security controls are not well managed. The primary control mechanism in many of the new systems is the management and control of user access rights and privileges. We found that too many individuals are provided broad system access, or that individuals are given permission to perform certain functions incompatible with their other roles and responsibilities. Consequently, information could be lost or corrupted.

- **Monitoring controls.** Monitoring controls require substantial improvement. These controls are an integral part of any control framework because they engage senior management in analyzing the reasonableness of results. Without sufficient monitoring controls, data accuracy and validity may be compromised, and inaccurate or unauthorized expenditures may result. Management needs to do more than simply compare actual results with either budget figures or overall appropriation limits; such basic forms of review often fail to identify errors that have occurred but that are masked because expenses are within budget. Particular attention needs to be given to key financial performance measures (such as changes in the capital assets or liabilities under a manager's control, or the aging of accounts receivable); the review of control and subsidiary ledger accounts; the review of unusual or higher-risk transactions, including selected grant and contribution payments; the review of suspense account balances; and the performance of periodic reconciliations of key control accounts (for example, accounts receivable, intergovernmental transactions, and cash).

- **New financial systems.** Departments are not fully exploiting the capabilities of their new financial systems. In many cases, these systems are used to do nothing more than compile the results produced using previously existing systems. As a result, many departments are maintaining their original systems and processes and developing interfaces between them and the new systems, rather than seeking opportunities to improve integration of these systems and processes. This approach to systems development and integration adds to the complexity and operational costs within the department because it must maintain both old and new systems and practices. Eventually these older systems will require extensive renovation or replacement. Departments need to ensure that their information systems planning gives consideration to the integration of the older systems with the new financial systems approved by the Treasury Board Secretariat.

5.35 Our audit of the government's summary financial statements also identified problems in the quality of departmental financial information. Examples included the following:

- a lack of timely reconciliations of control and suspense accounts;

- errors in completing Public Accounts submissions;

- unreconciled interdepartmental transactions; and

- corrections to departmental financial information in the course of the audit, including several significant corrections to account balances at the very end of the audit.

5.36 Departmental self-assessments, performed as part of preparing for implementing the Comptrollership Modernization Initiative, have also revealed a number of deficiencies in the key areas of exercising effective stewardship over resources and the ability to combine or integrate financial and other performance information for decision making (see our April 2002 Report, Chapter 7, Strategies to Implement Modern Comptrollership). Our earlier assessment of financial management capabilities in five departments yielded similar results (see our October 2000 Report, Chapter 13, Assessment of Financial Management Capabilities in Departments).

5.37 These comptrollership capabilities and the quality of the underlying financial information used for decision making are critical to a department's ability to improve its financial management practices and to understand the financial implications of its decisions. In May 2002, the Treasury Board Secretariat issued guidance to departments and agencies on implementing the Comptrollership Modernization Initiative. To address issues identified in their modern comptrollership capacity self-assessments, departments and agencies were required to develop action plans, including a communications and development strategy, that would strengthen the elements of modern comptrollership.

5.38 **Recommendation.** The Treasury Board Secretariat should ensure that departments have plans and strategies for improving the quality of their financial information that supports departmental financial reporting and analysis and, ultimately, the preparation of the government's summary financial statements.

Treasury Board Secretariat's response. The Treasury Board Secretariat is taking a serious look at the financial reporting and analysis capacity and practices within departments along with the data quality of financial information. One of the major accomplishments of the implementation of the Financial Information Strategy is that, for the first time ever, all departments are now required to produce a full set of accrual-based financial statements. These financial statements are currently being evaluated at the Secretariat and feedback will be provided to departments. Based in part on this feedback, the working group on departmental financial statements will develop appropriate data quality and other standards to support departments in their financial statement preparation and analysis.

Senior full-time financial officers have been requested to attest to the ongoing data quality of their financial information and to produce financial statements for internal analysis purposes. The Treasury Board Secretariat continues to work closely with the Receiver General in the identification and resolution of data quality issues. The Receiver General monitors information provided by departments on a monthly basis and provides prompt feedback for departmental review and correction. Additional guidelines are being prepared to strengthen the integrity of year-end reporting.

The study of accrual-based budgeting and appropriations needs to be completed

5.39 Our most recent audit of the Government's summary financial statements indicated that departments continue to spend time making adjustments between accrual-based accounting for reporting purposes and cash-based accounting for budgeting and appropriations. As noted in our December 2001 Report, Chapter 1, Financial Information Strategy: Infrastructure Readiness, many departments [illegible] [illegible] [illegible] [illegible]

5.40 The Standing Committee on Public Accounts has [illegible] a number of recommendations [illegible] accrual appropriations and budgeting (Exhibit 5.6) and [illegible] the Treasury Board Secretariat [illegible] the area. [illegible]

Exhibit 5.6 Standing Committee on Public Accounts: Recommendations on accrual appropriation and budget

Report date	Recommendation	Government response
1 December 1998	The Treasury Board Secretariat should complete as quickly as possible its consultations with its stakeholders in order to determine the best possible options to move the appropriations (supply) process to full accrual basis.	Progress is slower than anticipated. Response to a consultation paper is expected by 15 March [illegible] from which recommendations to government will be made in the following two or three months.
22 March 2000	The Treasury Board Secretariat should complete its consultations with departments and agencies on moving to accrual appropriations. Once the consultations are completed, the Treasury Board Secretariat should inform Parliament and the Public Accounts Committee in writing of its final decision and recommendations to the government on moving to accrual appropriations.	Responses to the consultation paper have been received and are being compiled and analyzed. Completion of the analysis is expected by September 2000, although further review of accrual-based budgeting and its relationship with appropriations may be required.
29 March 2001	The Treasury Board Secretariat should complete its consultations with parliamentarians aimed at determining the best possible options to convert the appropriations (supply) process toward full accrual basis and report the results to the House of Commons by 31 March 2002; the Government of Canada should move to an accrual-based system of appropriations (supply) by 1 April 2003.	The subject of accrual-based appropriations is very complex and requires careful review and consultation. Any decision made will have tremendous impact and consequences for government. This strongly underlines the need for very careful, rigorous and exhaustive study before making any decisions in the area.
10 May 2001	The Treasury Board Secretariat should undertake and complete the required studies and consultations on full accrual-based appropriations, and it should prepare a set of proposals and alternatives to be presented to the House of Commons Standing Committee on Public Accounts, no later than 31 March 2002.	The subject of accrual-based appropriations is very complex and requires careful review and consultation. The decisions made respecting any contemplated changes to our budgeting and appropriations practices will have tremendous impact and consequences for government. This strongly underlines the need for very careful, rigorous, and exhaustive study before making any decisions in the area.

[illegible]

The study of accrual-based budgeting and appropriations needs to be completed

5.39 Our most recent audit of the government's summary financial statements indicated that departments continue to face difficulty in making adjustments between accrual-based accounting for reporting purposes and cash-based accounting for budgeting and appropriations. As noted in our December 2001 Report, Chapter 1, Financial Information Strategy: Infrastructure Readiness, many departments suggested that unless the government moves to accrual-based budgeting and appropriations, managers will not focus on accrual-based information. Departments were virtually unanimous in asking that all financial information be produced on an accrual basis.

5.40 The Standing Committee on Public Accounts has continued to support our recommendation concerning accrual appropriations and budgeting (Exhibit 5.6) and has repeatedly urged the Treasury Board Secretariat to act on this issue. The government's response has been that

Exhibit 5.6 Standing Committee on Public Accounts: Recommendations on accrual appropriation and budget

Report date	Recommendation	Government response
1 December 1998	The Treasury Board Secretariat should complete as quickly as possible its consultations with its stakeholders in order to determine the best possible options to move the appropriations (supply) process to full accrual basis.	Progress is slower than anticipated. Response to a consultation paper is expected by 10 March 2000 from which recommendations to government will be made in the following two or three months.
22 March 2000	The Treasury Board Secretariat should complete its consultations with departments and agencies on moving to accrual appropriations. Once the consultations are completed, the Treasury Board Secretariat should inform Parliament and the Public Accounts Committee in writing of its final decision and recommendations to the government on moving to accrual appropriations.	Responses to the consultation paper have been received and are being compiled and analyzed. Completion of the analysis is expected by September 2000, although further review of accrual-based budgeting and its relationship with appropriations may be required.
29 March 2001	The Treasury Board Secretariat should complete its consultations with parliamentarians aimed at determining the best possible options to convert the appropriations (supply) process toward full accrual basis and report the results to the House of Commons by 31 March 2002; the Government of Canada should move to an accrual-based system of appropriations (supply) by 1 April 2003.	The subject of accrual-based appropriations is very complex and requires careful review and consultation. Any decision made will have tremendous impact and consequences for government. This strongly underlies the need for very careful, rigorous, and exhaustive study before making any decisions in the area.
10 May 2001	The Treasury Board Secretariat should undertake and complete the required studies and consultations on full accrual-based appropriations, and it should prepare a set of proposals and alternatives to be presented to the House of Commons Standing Committee on Public Accounts, no later than 31 March 2002.	The subject of accrual-based appropriations is very complex and requires careful review and consultation. The decisions made respecting any contemplated changes to our budgeting and appropriations practices will have tremendous impact and consequences for government. This strongly underlies the need for very careful, rigorous, and exhaustive study before making any decisions in the area.

Source: Adapted from reports of the Standing Committee on Public Accounts extensive study is required before a decision can be made and that there is little likelihood of meeting the Committee's suggested target date of April 2003 for introducing accrual budgeting and appropriations. These positions were restated most recently on 11 June 2002, at the meeting of the Standing Committee on Public Accounts.

5.41 The Treasury Board Secretariat has done some preliminary research and held initial consultations with departments. In August 2001, it hired a manager to complete a study and make a recommendation by the fall of 2002. Other than these steps, the Secretariat has made little progress on the issue.

5.42 Resolving this issue will entail a major effort, no matter which course of action is selected. We agree with the conclusion of the Standing Committee on Public Accounts in its Seventh Report to the 36th Parliament. The report noted that the pace of consultations on moving to accrual appropriations is slow, and it stated, "The government must take a clear position on this issue and enforce its position promptly; otherwise, vagueness may jeopardize implementation [of accrual financial information] overall."

5.43 **Recommendation.** By March 2003, the Treasury Board Secretariat should complete the study of accrual-based budgeting and appropriations and present the proposed approach for a common basis of planning, budgeting, and reporting, along with an implementation plan, to the House of Commons Standing Committee on Public Accounts.

Treasury Board Secretariat's response. In responding to the Public Accounts Committee's May 2001 report, the Treasury Board Secretariat noted the complexity of the issues associated with accrual budgeting and appropriations and the need for careful review and consultation. The full text of this response is contained in Exhibit 5.6 of this chapter and continues to be the Secretariat's position. Since the time of that response, the Secretariat has made significant progress in terms of characterizing the issues, assessing international experience, and with consultations that include the Auditor General's own staff. Consultations of adequate breadth and depth need to be concluded with a sufficient range of departmental officials as well as with other stakeholders, which include Parliament. International experience continues to evolve and will in fact be the subject of an Organization for Economic Co-operation and Development meeting in 2003 at which Secretariat officials will participate. For these reasons, along with those noted in its response to the Public Accounts Committee, the Treasury Board Secretariat is not prepared either to set or to agree to an arbitrary deadline for concluding its study, but it assures the Auditor General that the issue remains a priority on which it will continue to consult with her staff and report progress.

Issues delaying accrual accounting for government financial statements need to be resolved

5.44 In the 2001 Budget, the government stated that it would delay the implementation of full accrual accounting for its summary financial statements for at least one year because of the timing of the Budget and because important components of the information required to implement full accrual accounting had not been verified and audited.

5.45 The move to full accrual accounting will require the government's summary financial statements to include, for the first time, tangible capital assets, assets for purchased or developed software, inventories, environmental liabilities, taxes receivable, prepaid expenses, employee future benefits other than pensions, and revised methods of accounting for Aboriginal claims. As a result of these changes, tens of billions of dollars of assets and liabilities will be recognized that were not previously valued and recorded in the government's summary financial statements. To a lesser extent, these changes will also affect the surplus or deficit of the government because, for example, full accrual accounting will require that tangible capital assets be amortized (expensed) over the period they are used, that inventories be expensed as used, and that tax revenues be recorded in the period to which they pertain. The Office of the Auditor General of Canada acknowledges the significance of these changes and supports the government's move to implement full accrual accounting in the summary financial statements.

5.46 Our recent audit of the government's summary financial statements, including observations reported in the *Public Accounts of Canada* for 2002, offered some examples of how accrual accounting will provide better information on recent activities of the government.

- In the 2001 Budget, the government announced a deferral of income tax instalments for small businesses. Under the government's policy of recognizing income taxes on a cash basis, about $622 million of income taxes were not recognized as revenue in the current fiscal year even though the taxes deferred related to that fiscal year. The estimated deferral thus reduced the overall government surplus for 2001–02 by $622 million. Under accrual accounting standards, these revenues would have been recorded as taxes for the fiscal year, with a related amount owing to the government as part of the government's financial position. This case demonstrates how accrual accounting standards would properly match the recording of tax revenue to the fiscal year to which it pertains, and would also identify the related taxes receivable. The results for the 2001–02 fiscal year would not have been altered merely by changing the timing of cash flows.
- During 2001–02, the government paid about $4 billion for capital assets, including several new buildings and some armoured personnel carriers. These acquisitions reduced the surplus for the year by about $4 billion because the government's practice is to recognize the purchase of capital assets as expenditures. Under accrual accounting, such items would have been recorded as assets because they have a useful life beyond the year in which they were acquired. This method of recording the transactions would have affected the surplus for the year only by the amount that those assets and existing assets were amortized during the year, and not by the full amount disbursed. The approach would have provided a more complete picture of the government's assets and operational results.

5.47 In addition, the government's current accounting practice of recording transfers to arm's-length organizations as expenditures in the year in which the payments are made will need to be reconsidered once the Canadian Institute of Chartered Accountants' Public Sector Accounting Board has completed a review of the accounting standards for transfer payments. By following its current accounting practice, the government does not consider whether the payments are in advance of the recipient's current operating needs or whether the funds are immediately required for the purposes intended. The result has been that, in addition to about $7.5 billion in funds transferred to foundations (as discussed in our recent observations on the *Public Accounts of Canada* for 2002), the government has transferred some $400 million since 1999 to a number of arm's-length organizations, and the organizations continue to hold the transferred funds in the form of either cash or investments.

5.48 Our most recent audit of the government's summary financial statements revealed that more work is needed to complete the government's summary financial statements on a full accrual basis. The Canada Customs and Revenue Agency, the Treasury Board Secretariat, and the Department of Finance Canada have agreed on a methodology for determining tax revenue on a full accrual basis, but the resulting figure had not been fully verified and audited at the time of writing this chapter. In addition, we have identified problems in the unit prices and quantities used by the Department of National Defence in its valuation of consumable inventories. These are government supplies held for use in operations, with a useful life of over one year (mainly National Defence ammunition and spare parts).

5.49 The Canada Customs and Revenue Agency states that it is reasonably confident in the process that it has followed in its initial determination of the accrual estimate for tax revenue. While the information has been reviewed by the Agency, the Treasury Board Secretariat, and the Department of Finance, it has not yet been fully verified and audited. National Defence also states that it is confident that it will be able to resolve the outstanding issues regarding the valuation of consumable inventories and therefore meet its obligations with respect to the implementation of accrual accounting. Delays in finalizing either of these issues, however, could jeopardize the recording of these assets in the government's summary financial statements and ultimately the implementation of full accrual accounting for those statements.

5.50 Our most recent audit of the government's summary financial statements, including our observations reported in the *Public Accounts of Canada* for 2002, noted that the government made significant changes to some of its current management estimates almost six months after the end of the 2001–02 fiscal year. The government's summary financial statements, like those of most other large organizations, include a number of significant management estimates. These estimates affect billions of dollars of reported assets and liabilities and ultimately the surplus or deficit for the year. Examples of the government's more significant management estimates currently include the estimation of losses on loans and investments, the determination of its liability for pension obligations, and the estimation of losses arising from various claims against the government. As the government moves toward adopting full accrual accounting, management estimates will become a more important part of the process of preparing the government's summary financial statements. Management estimates, in a full accrual environment, will be required in the recording of tax revenues, environmental liabilities, Aboriginal claims, and numerous other amounts. As a result, we believe that the government needs to improve its processes for developing, reviewing, challenging, and eventually recording management estimates.

5.51 Finally, the government encountered difficulties in preparing its summary financial statements for the fiscal year ending 31 March 2002 because it had to convert some of the full accrual financial information submitted by departments back to the government's required presentation under its existing stated accounting policies. In particular, the government had difficulties in ensuring an accurate reversal of tangible capital assets and related expenses recorded on an accrual basis of accounting back to the government's existing practice of recognizing such items as expenditures when purchased. Although the government was eventually able to properly adjust the accrual financial information, we believe that it needs to resolve the outstanding issues related to the implementation of full accrual accounting to prevent such difficulties in the future.

5.52 **Recommendation.** The Treasury Board Secretariat should resolve the outstanding issues related to the implementation of full accrual accounting in the summary financial statements, including the processes for determining management estimates, and prepare the government's summary financial statements on a full accrual basis for the year ending 31 March 2003.

Treasury Board Secretariat's response. The Minister of Finance announced in his October 2002 Economic and Fiscal Update the intention of the government to implement full accrual accounting in the upcoming budget and summary financial statements of the government provided that the accrual amounts for fiscal 2001–02 have been verified and audited with the support of the Auditor General.

5.53 As noted in earlier observations on the *Public Accounts of Canada* and in our December 2001 Report, Chapter 1, Financial Information Strategy: Infrastructure Readiness, the government's present model for departmental financial statements does not require the recording of some significant liabilities and costs: environmental liabilities; allowances for loans, investments, and advances; employee termination benefits; and contingent liabilities. In our view, without this information, the financial statements do not provide accurate and reliable information on departments' program costs and financial positions.

5.54 The Treasury Board Secretariat has told departments that it plans to deal with these items once the other aspects of accrual accounting have been addressed and the departments have appropriate management control frameworks in place.

5.55 **Recommendation.** The Treasury Board Secretariat should promptly resolve the outstanding accrual accounting and management control framework issues regarding departmental financial statements and establish a target date for finalizing auditable departmental financial statements.

Treasury Board Secretariat's response. The Treasury Board Secretariat has already devolved to departments the recording of certain transactions previously recorded centrally. The working group on departmental financial statements will address the issue of departmental management control frameworks. Concurrently, the Secretariat will study the remaining transactions recorded centrally to ensure that, in future, departmental financial statements present information both fairly and fully. Departmental financial statements will continue to disclose their stated accounting policies. In addition, certain departmental financial statements are being audited.

Leadership, skills, and support

5.56 Our observations arising from the audit of the government's summary financial statements have indicated that departments and/or central agencies are experiencing difficulty with their internal control systems, the quality of their financial information, and the preparation of their accrual financial statements—all important aspects of improving financial management and control in the government.

5.57 But improving financial management and control in the government is not simply a matter of recording transactions and preparing financial statements, or of implementing new financial systems. If it were, the government would have spent a considerable amount of time and money, and received little benefit in return. For example, the Treasury Board Secretariat estimated that $635 million has been spent on implementing new financial systems and moving to accrual accounting; however, we are uncertain whether this estimate is reliable because we have concerns about the completeness and accuracy of the information on which it is based (see our December 2001 Report, Chapter 1, Financial Information Strategy: Infrastructure Readiness).

5.58 Plans to improve financial management practices, adopt accrual accounting, and upgrade financial information systems are merely the tools and framework that make improved financial management and control possible; they do not in themselves ensure that financial management and control in the government is effective or successful. For the government to realize the full return on its considerable investment in these initiatives, it needs to effectively integrate accrual accounting and the improved financial systems with modern comptrollership, the other elements of the Financial Information Strategy, and the elements of responsible spending and results reporting noted in *Results for Canadians*. Successful integration of these various initiatives must then be followed by decision making within departments, by senior officials in the government and by parliamentarians, that is based on accrual financial information and the new financial systems, within the broader management framework of the government.

Central leadership and support are needed

5.59 As outlined in *Results for Canadians*, the Treasury Board Secretariat is responsible for guiding departments and agencies as they improve their management and accounting practices. Within the Secretariat's organizational structure, the Comptroller General of Canada is responsible for handling matters related to financial management. This officer needs to provide the senior leadership to ensure that all of the key financial management initiatives of the government are integrated, by creating the right environment for change and by developing a strategy for success.

5.60 Departmental managers will not change their behaviour or practices unless they perceive a benefit to doing so or a consequence to not changing. They need to know *why* they should change. The new environment for change needs to provide departments with an understanding of the reasons and objectives for change, the incentives for change, and the tools and guidance for effecting change. All of these elements need to be balanced with effective monitoring and oversight.

5.61 With the inclusion of the aspects of modern comptrollership as a priority in the Clerk of the Privy Council Office's 2002–03 Deputy Minister performance agreements, the profile of financial management has been raised, including both the requirement to incorporate financial information into decision making and reporting to Parliament and the requirement to implement appropriate control systems. The Comptroller General could build on this initiative by encouraging deputy heads to incorporate elements of modern comptrollership and accrual accounting in the performance objectives of their staff; offering deputy heads information on the benefits, best practices, and achievements of modern comptrollership and accrual accounting; and suggesting that they periodically address their departments' progress in implementing modern comptrollership and accrual accounting.

5.62 The establishment of a strategy and implementation plan for the next phase of modern comptrollership has been an important step toward advancing financial management and control in the government because it includes the following:

- creating conditions for long-term success of the initiative by building a better understanding of comptrollership, putting in place essential tools and guidance, and strengthening accountabilities for management improvement;
- developing a comprehensive learning strategy for comptrollership;
- providing ministers with a more integrated picture of the state of comptrollership;
- emphasizing modern comptrollership as a foundation for modern management;
- obtaining a long-term commitment to modern comptrollership from all departments and agencies; and
- developing an approach to measuring progress across the government.

5.63 All of these items are important to advancing financial management and control in the government, particularly the implementation of full accrual financial information for decision making and the effective use of financial information system capabilities. As we noted, however, in our April 2002 Report, Chapter 7, Strategies to Implement Modern Comptrollership (discussing the Treasury Board Secretariat's monitoring of modern comptrollership), the Comptroller General may need to advance financial management and control in the government more aggressively if the desired outcomes are to be achieved.

5.64 The Comptroller General could do so by increasing the monitoring of financial management and control practices in departments and by embedding additional incentives directly into government operations. For example, the Comptroller General could reject any Treasury Board submissions that do not incorporate the use of accrual-based information; provide challenge and feedback on financial results and information prepared by departments on a full accrual basis, such as departmental financial statements or departmental performance reports; require departments to report on the adequacy of their internal controls; and demonstrate commitment by resolving the outstanding issues of accrual budgeting and appropriations and of accrual accounting for the summary-level and departmental financial statements.

5.65 **Recommendation.** The Comptroller General of Canada should aggressively advance financial management and control in the government by monitoring and influencing departmental and government-wide use of accrual financial information and financial information systems, as well as by introducing other incentives directly into government processes.

Treasury Board Secretariat's response. The government has implemented full accrual accounting at the departmental level in the 2001–02 fiscal year. The Government-wide Implementation-Strategic Plan of its modern comptrollership initiative for 2001–04 is structured around three priorities: understanding and awareness, tools and guidance, and accountability.

Specific actions are being taken by the Treasury Board Secretariat to support all three priorities. For example, guidance on the preparation of departmental modern management action plans has been published; specific tools on integrated control systems and the integration of financial and non-financial information are under development; and the new Web site launched by the Secretariat gives managers access to over 300 best practices.

A modern management accountability and reporting framework is also under development and will be implemented over the next two years. The Treasury Board Secretariat is developing communities of practice so that organizations can learn from each other by sharing their experiences. The Secretariat is now meeting with departments and agencies on their individual action plans and on their efforts to entrench and sustain modern comptrollership as their way of doing business.

Departmental leadership and skills are needed

5.66 As stated in *Results for Canadians*, the government's new management framework requires individual departments to foster sound decisions by producing information on program costs and results. Departments need to link costs with actual or expected results by integrating financial and non-financial performance information. Under the Comptrollership Modernization Initiative, individual departments are required to manage their resources wisely, with due regard to economy, efficiency, and effectiveness. They need to deal effectively with risk and to establish a proper internal control environment. Departments need modern management practices and frameworks, along with the necessary infrastructure to be able to fulfill these requirements and effectively deliver programs (*Guidance for Developing Action Plans for Implementing Modern Comptrollership*, Treasury Board Secretariat).

5.67 This approach to financial management means that the quality of the required decisions and analysis will depend on the people who prepare and use the information—those who explain the numbers, those who use them to support decisions with financial analysis, and those who foresee problems and recommend corrective action using the financial information.

5.68 The Clerk of the Privy Council Office's performance agreements with deputy heads call for them to advance the Comptrollership Modernization Initiative at a departmental level and to therefore introduce the use of accrual financial information in their departments. We support this approach and believe that it needs to also apply to other senior officials in each department—in particular, the senior financial officer and the senior full-time financial officer since these officers hold the most senior financial positions within a department.

5.69 In today's management environment, senior financial officers are expected to provide support to their senior management group for key decisions. The senior financial officers must promote the use of accrual financial information by senior officials within the department and convince them of the benefits of using that information in daily decision making. Consequently, those responsible for advancing financial initiatives in a department would benefit from backgrounds and professional training in accounting. These qualifications would enable them to fully understand the impact of full accrual accounting on departmental decisions, such as the costing of activities and alternative delivery mechanisms, the assessment of the adequacy of revenues relative to costs in a cost recovery situation, and the analysis of capital asset acquisitions. Senior financial officers must also be able to provide coaching and supervision to the staff who are charged with accurate and timely preparation of this departmental financial information.

5.70 In a survey of nine of the largest departments covered in our most recent audit of the government's summary financial statements, we sought to identify whether the individuals holding the positions of senior financial officer and senior full-time financial officer were professional accountants. We discovered that the incumbents were professional accountants in only

33 percent of the cases and that, collectively, the departments that they managed accounted for 63 percent of the government's total operating budget of almost $180 billion.

5.71 We acknowledge that the incumbents of these positions have a broad range of experience and academic credentials, including a Master of Business Administration degree in a few cases. Further, we recognize that many qualities are required of senior financial officers. We would have expected, however, a higher percentage of the senior financial officers to be professional accountants. By contrast, 80 percent of the senior financial officers in the 10 top revenue-generating Canadian public companies were professional accountants. As previously stated, we believe that a background and professional training in accounting is a beneficial attribute in championing the key financial management initiatives of the government and ensuring the quality of an organization's financial information.

5.72 We are also aware that the departments concerned have more junior staff with accounting designations, but senior levels within the organization need to establish the environment for change and ensure the successful implementation of the government's financial management initiatives. The senior leadership responsibility cannot be delegated to more junior positions.

5.73 **Recommendation.** The Comptroller General of Canada should develop a strategy and action plan for improving the representation of professional accountants in the positions of senior financial officer and senior full-time financial officer.

Treasury Board Secretariat's response. The role of the senior financial officer in government departments is often much broader than issues of finance and accounting and in many respects is considerably more varied than that found in the private sector. For this reason, incumbents have been drawn from a variety of disciplines pertinent to the overall role that they have been asked to play. This is particularly the case for smaller departments and agencies. Although the role of the senior full-time financial officer is more focussed in the domain of finance and accounting, the government believes that competencies and academic qualifications, other than simply a professional accounting designation, can be quite appropriate for these positions. It is quite possible for incumbents to have acquired extensive experience and knowledge in areas of accounting and financial reporting without necessarily acquiring an accounting designation. The government has the utmost confidence in the executives filling these roles at the present time.

With the implementation of accrual accounting and modern comptrollership, it is expected that the capacity of financial officers to enhance financial reporting for decision making will be greatly increased. Their knowledge of accrual accounting and budgeting concepts will be prerequisites for this to fully succeed. The government intends to study the profile of its entire financial community, and the concern expressed by the Auditor General will be given full consideration in succession planning.

Conclusion

5.74 Financial management and control is vital for achieving results for Canadians. It involves the use of financial and non-financial information in decision making, and the effective implementation of financial information systems and controls. The Office of the Auditor General of Canada fully supports the government's implementation of improved financial management practices, including the adoption of full accrual accounting.

5.75 Financial management reform has been an elusive goal in the Government of Canada for over 40 years. While there has been some progress in this area, more work is needed to strengthen financial management and control in the government and to make it effective. This involves more than simply preparing accrual financial statements or developing guidance on modern management practices. A change must occur at all levels in the way that the government uses financial information.

5.76 First and foremost, it is essential that the government resolve the issue of accrual budgeting and appropriations. While we accept that this issue is complex and needs to be carefully considered, we note that the government is still far from being able to propose the way forward after almost five years of studying the issue. In our view, until government-wide and departmental budgeting, financial reporting, and appropriations are put on a common basis, effective financial management and control in the government will not be achieved.

5.77 Second, the Comptroller General of Canada needs to build on the momentum created by the importance and priority assigned to the Comptrollership Modernization Initiative by the Clerk of the Privy Council. The Comptroller General could do so by aggressively advancing financial management and control in the government, including monitoring and influencing departmental use of accrual financial information and requiring reports on the adequacy of internal controls, developing a strategy to increase the representation of professional accountants in the positions of senior financial officer and senior full-time financial officer, and embedding other incentives directly into government processes.

5.78 Departments need to improve the quality of their financial information that supports departmental financial reporting and analysis and, ultimately, the preparation of the government's summary financial statements. They also need to improve their monitoring control practices; develop appropriate internal controls that integrate electronic and manual processing controls, including effective electronic security controls; and fully exploit the capabilities of their new financial systems. Further, departments need to engage their internal audit functions in providing assurance on their financial accounting and related systems, as required by the Treasury Board's Policy on Internal Audit.

5.79 Finally, the government needs to resolve the outstanding issues regarding departmental and summary accrual financial statements, including the processes for determining management estimates, so that it can adopt full accrual financial reporting for the summary financial statements for the year ending 31 March 2003.

About the Chapter

Objectives

For this chapter, we wanted to determine the extent of the government's progress in implementing accrual accounting and in implementing financial information systems designed to produce accrual-based financial information. We also wanted to know what the government had decided to do about accrual budgeting and appropriations.

Scope

The findings and conclusion presented in this chapter are derived from the results of our most recent audit of the summary financial statements of the Government of Canada, from other audit work performed by the Office of the Auditor General of Canada in this area, and from meetings with government officials.

The audit of the summary financial statements was conducted according to Canadian generally accepted auditing standards. We assessed whether the summary financial statements were fairly presented in accordance with the government's stated accounting policies. Our resultant opinion and observations on matters related to accounting treatments and disclosures are included in the *Public Accounts of Canada* for 2002.

Approach

We did not develop a separate strategy and criteria for our work. Instead we relied on the nature, scope, and extent of our audit of the summary financial statements of the Government of Canada. As a result, this chapter is not an audit of financial management and control in the government. Rather it is an account of our observations arising from the audit of the government's summary financial statements and from other audit work done by the Office of the Auditor General of Canada and that we believe are important for improving financial management and control in the government.

The procedures we followed included testing a sample of transactions and account balances, performing analyses, confirming year-end balances with third parties, reviewing significant internal controls as necessary, and discussing significant matters with government officials.

Audit team

Assistant Auditor General: John Wiersema
Principal: Clyde MacLellan
Directors: Dawn Campbell, Frank Vandenhoven, and John Dunning

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Appendix Accrual accounting

What is accrual accounting?

Accrual accounting refers to an underlying basis of accounting used to record the financial transactions of an entity. Accrual accounting recognizes transactions and other events when they occur, rather than when cash or its equivalent is received or paid.

Accrual accounting records expenses in the period when the goods or services are consumed, it records revenues in the period to which they pertain, and it matches multi-year benefits associated with long-lived assets to the time when they are expected to be used.

Why is accrual accounting important in government?

Accrual accounting helps users appreciate the full scope of government—the resources, obligations, financing, costs, and impacts of its activities (including the costs of consuming assets over time). This more complete picture enables legislators to hold the government more accountable for the stewardship of its assets, the full costs of its programs, and its ability to meet short-term and long-term financial obligations.

Accrual accounting can also help improve decision making within departments, for example, as follows.

- Managers increase their focus on the stewardship of assets because all assets are recorded in the financial accounts of the department. Managers become more aware of the assets under their control and the need to consider such issues as maintenance requirements, replacement policies, the identification and disposal of excess assets, risks such as loss caused by theft or damage, and the full impact of assets on service delivery.
- Managers increase their attention to the management of liabilities under their control because existing and potential liabilities are recognized. Managers become more aware of their responsibility for these liabilities and the need to develop plans for managing them, including identifying the impact of existing liabilities on future resources. If liabilities are not recognized, there is less reason for managers to consider certain issues and effectively manage those liabilities.
- With all the costs of operations being recorded in the accounts of the department, managers become more aware of the complete picture of their financial performance (all costs and revenues). Managers are then more inclined to consider all of those costs in making various decisions, such as the evaluation of the cost-effectiveness of in-house delivery versus contracting for services, the appropriateness of a cost-recovery policy, or the amount to charge other departments for services provided.

Report of the Auditor General of Canada to the House of Commons—December 2002

Main Table of Contents

Matters of Special Importance—2002
Foreword and Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada—Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada—Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

Appendices

2002

Report of the
Auditor General of Canada
to the House of Commons

DECEMBER

Chapter 6
Statistics Canada—
Managing the Quality of Health Statistics

Office of the Auditor General of Canada

The December 2002 Report of the Auditor General of Canada comprises 11 chapters, Matters of Special Importance—2002, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

Ce document est également disponible en français.

© Minister of Public Works and Government Services Canada 2002
Cat. No. FA1-2002/2-14E
ISBN 0-662-33112-5

Chapter

6

Statistics Canada

Managing the Quality of Health Statistics

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

Table of Contents

Main Points 1

Introduction 5

Recent developments in Canada related to health statistics 5
Collecting health statistics 6
Focus of the audit 8

Observations and Recommendations 9

Quality of Statistics Canada's health statistics 9

Data quality assurance is well established in Statistics Canada 9
The Agency's health statistics programs meet its data quality standards 9
The Health Statistics Division applies and systematically assesses its data quality procedures through Integrated Program Reporting 10
Statistics Canada is leading work to strengthen integrity of vital statistics data 12
Statistics Canada is working with provincial and territorial cancer registries to improve data quality 13
Additional data quality work is needed for the Hospital Person-oriented Database 13
The Canadian Community Health Survey meets data quality standards 14
The Health Services Access Survey meets data quality standards 15
Getting to good-quality statistics 15
Statistics Canada's disclosure to users of quality of health statistics is uneven 15
Insufficient monitoring of the quality of statistics supplied by the Canadian Institute for Health Information 17
Limited reporting to Parliament on the quality of health statistics by Statistics Canada 20

Quality of Health Canada's health statistics 21

Limited application of data quality practices to health statistics 21

Verifying the accuracy of health indicators data 22

Work undertaken by the Canadian Council of Legislative Auditors 22

Meeting health information needs 23

Health Canada's monitoring of the Health Information Roadmap Initiative is weak 24

Conclusion 25

About the Audit 27

Appendix

Jurisdictions' verification of health indicators reports 29

Statistics Canada
Managing the Quality of Health Statistics

Main Points

6.1 Good-quality statistics are fundamental to an informed public debate on health issues. Statistics Canada is one of the key providers of health statistics. It has put in place a wide range of systems and practices to build quality into its statistical programs and to ensure that data quality remains a priority. Our audit found that Statistics Canada's data quality assurance systems and practices are sound and that the Health Statistics Division applies these to its health statistics programs. This has resulted in statistics that meet the Agency's data quality standards. We found that the health statistics produced by Statistics Canada for the September 2002 federal, provincial, and territorial health indicators reports are sufficiently accurate for this use.

6.2 Because Health Statistics Division's surveys are under its direct control, the Division makes necessary improvements to maintain data quality when the need arises. In co-operation with the organizations that provide administrative data to Statistics Canada, the Division is leading work to maintain and improve the quality of the data. We concluded that, with the exception of one database, Statistics Canada's quality assurance systems and practices adequately ensure the quality of its health statistics.

Background and other observations

6.3 Current attention to health issues includes a focus on developing health indicators that measure the health status and health outcomes of Canadians. The Communiqué on Health from the September 2000 First Ministers' Meeting included a commitment for governments to report regularly on health indicators, beginning in September 2002.

6.4 Our audit focussed on databases and surveys that provided data for these reports. At the federal level, the two main organizations involved in collecting health statistics are Statistics Canada and Health Canada. Most of the data came from Statistics Canada, with some from Health Canada and the rest provided by the Canadian Institute for Health Information (CIHI) and by the provinces and territories.

6.5 Statistics Canada's Health Statistics Division has a mandate to provide accurate, timely, and relevant information about the health of Canadians and the health care system. The Division works to ensure that its health statistics meet Statistics Canada's data quality standards. It is responsible for vital statistics (births, deaths), cancer data, data for indicators on health outcomes, and health surveys.

6.6 All statistics are, to some extent, estimates of the reality they seek to convey. Therefore, they have to be used with a sound understanding of their strengths and limitations. However, the Health Statistics Division's application of Statistics Canada's policy on informing users of data quality and methodology is inconsistent. While Statistics Canada has established a single database for informing users on data quality, the information in the database is not complete. The Agency needs to develop an approach to help all program managers maintain current, complete information in the database.

6.7 It is important that the Division determine the quality of data it receives from other organizations so it knows to what extent these data can be relied on for their intended use. The Division receives data from the CIHI Hospital Morbidity Database that it uses to construct indicators on patient outcomes; however, the Division did not make a formal determination of data quality. We also found that the Agency did not formally monitor the accountability requirements of the Health Information Contribution Program. The Program's contribution agreement provides funding for the statistical databases that Statistics Canada transferred to CIHI, including the Discharge Abstract Database. This has implications for maintaining the quality of the transferred databases. We concluded that, with the exception of this database, the Health Statistics Division has quality assurance systems and practices to adequately ensure the quality of its health statistics.

6.8 Health Canada produces health statistics through national surveillance systems. These systems collect data on communicable and chronic diseases and injuries. Three of these systems provided data for the September 2002 health indicators reports. However, the quality assurance systems and practices for these databases do not ensure the accuracy of the data. Therefore it was not possible to form an opinion on the accuracy of these data. Improvements in these processes are needed.

6.9 Health Canada is also responsible for monitoring funding provided to CIHI under the Health Information Roadmap Initiative. We found that the Department does not actively monitor this initiative in accordance with the grant's requirements. As a result, it has no formal basis for knowing whether the Initiative's intended objectives are being achieved.

6.10 CIHI's Discharge Abstract Database and Hospital Morbidity Database provided data for several of the indicators in the September 2002 health indicators reports. Audit work led by the Office of the Auditor General of British Columbia found that documentation on the quality assurance process for the systems that provide the data is inadequate. As well, a three-year study that will provide information on the quality of the input data will not be completed for another two years. Therefore, it was not possible to form an opinion on the accuracy of the specific data provided by CIHI for the health indicators reports.

Statistics Canada and Health Canada have responded. Statistics Canada and Health Canada agree with our recommendations. However, Health Canada considers that our chapter does not acknowledge the substantial flow of information to Health Canada from the Canadian Institute for Health Information. Both entities have indicated in their responses that a number of actions are under way to deal with our recommendations.

Introduction

6.11 Health and health care issues continue to be intensely debated in Canada. Our aging society, evolving technologies, and access to services often feature in the news. Canadians are demanding transparency and accountability for decisions that affect their health services. Health care practitioners stress the importance of accurate information on diseases and their treatment. Fiscal restraint has led to greater discussion about the information needed to make funding and policy decisions. Reliable and meaningful health statistics can contribute to an informed debate on health issues.

6.12 By health statistics we mean data describing the health of Canadians and our health care system. Health statistics answer questions such as the following: What are the factors that influence good health? How many Canadians have heart attacks each year? Is that number going up or down? What health interventions are these people receiving? Are some interventions more effective than others, and what do they cost taxpayers? What preventive measures are effective and how widespread is their use?

6.13 The concept of health statistics has expanded over the years in Canada. Until the 1960s, most health statistics dealt with the incidence of illness. In the 1960s and 1970s, they began to reflect the financial and other costs of treating health conditions. The 1990s saw data used increasingly to construct indicators and measures related to issues such as determinants of health. Currently, much attention focusses on developing health indicators that measure the health status of Canadians and patient outcomes.

6.14 Better health statistics can help

- Canadians make more informed decisions about their health,
- physicians provide better care to patients by giving them empirical evidence on the outcomes of available medical procedures,
- health care managers improve the cost-effectiveness of care,
- researchers better understand the determinants of health, and
- governments formulate better health policy by giving them critical evidence and feedback to evaluate past decisions and the implications of future decisions.

Recent developments in Canada related to health statistics

6.15 Starting with the 1991 Report of the National Task Force on Health Information, there has been a greater focus in Canada on the importance of health statistics and on ways of improving them. Other key developments include the creation of the Canadian Institute for Health Information (CIHI) and the establishment of the Commission on the Future of Health Care in Canada. As well, the Communiqué on Health from the September 2000 First Ministers' Meeting included the commitment for governments to report regularly on health indicators, beginning in September 2002 (Exhibit 6.1).

Collecting health statistics

6.16 [illegible]

Exhibit 6.1 Key milestones for health statistics in Canada

[illegible] The National Task Force on Health Information observed deficiencies in existing data systems and concluded a health [illegible] recommended the creation of a non-governmental institute for health information to address these deficiencies.

[illegible] The Canadian Institute for Health Information (CIHI) was established in response to the Task Force recommendation.

[illegible] Health Canada [illegible] funding to CIHI via the Health Information Contribution Program. Under the [illegible] over five years to facilitate and coordinate at a national level the development and [illegible] integrated health information system, and to provide and [illegible] information required for establishing sound health policy, effectively [illegible] health system, and for creating public awareness about factors affecting good health.

[illegible] Health, Health Canada, and Statistics Canada, convened the first [illegible] Health Indicators. A framework was adopted and indicators were [illegible]

[illegible] to CIHI over four years to work on reporting regularly on the health care [illegible] was established as a collaborative effort among CIHI, Statistics [illegible] ministries of health, and other groups.

[illegible] to fund the Health Information Contribution Program until 2005. Under the [illegible]

[illegible] health in response to the federal government's provision of additional funds [illegible] First Ministers made a commitment to regular public reporting. Specifically, [illegible]

- [illegible] regular public reporting by each government on the health programs and services they [illegible] health system performance, and on progress toward priorities;
- [illegible] of a comprehensive framework using jointly agreed comparable indicator areas such that each government will begin reporting by September 2002. These 14 comparable indicator areas will address [illegible] health outcomes, and quality of service; and
- [illegible] independent third party verification to certify and analyze health system information.

[illegible] The Standing Senate Committee on Social Affairs, Science and Technology initiated a study on the role of the federal government in health care. The Committee issued reports in 2001 and 2002. The importance of good-quality health information was re-affirmed.

The Prime Minister announced the Commission on the Future of Health Care in Canada. The Commission issued an interim report in February 2002. The interim report commented that "despite recent efforts, good, comparable information [illegible] health care system—from waiting times, to costs, to treatment outcomes—is woefully lacking." The Commission issued its final report in November 2002.

The federal Budget [illegible] funding (an additional $95 million grant) to CIHI, to be used in conjunction with Statistics Canada, to continue to, among other things, develop common health indicators so that nationwide, comparable information is available.

2002 In September, the federal, provincial, and territorial governments released their health indicators reports.

Exhibit 6.2 Organization of health statistics in the federal government

Statistics Canada	Health Canada	Canadian Institute for Health Information
- [illegible]	- [illegible]	- [illegible]
- [illegible]	- [illegible]	- [illegible]
- [illegible]	- [illegible]	
- [illegible]		
- [illegible]		

6.17 **Statistics Canada.** [illegible]

6.18 [illegible]

6.19 **Health Canada.** [illegible] for delivering some health services to First Nations [illegible] on First Nations health.

6.20 **Canadian Institute for Health Information.** [illegible] a federally chartered but independent [illegible] mandate is to coordinate the development [illegible]

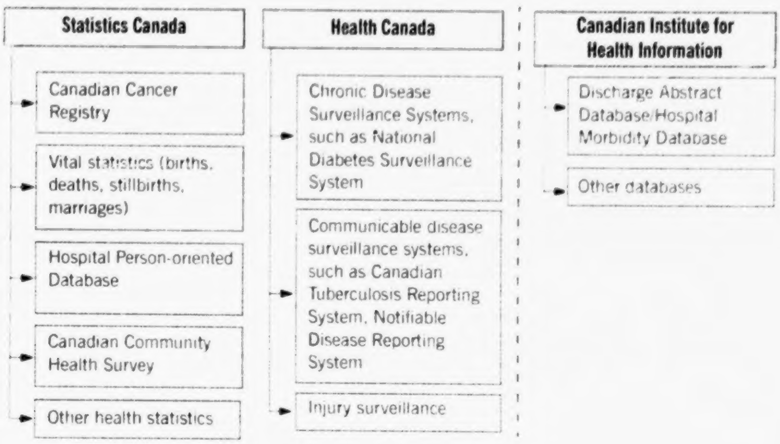
Collecting health statistics

6.16 There are three main organizations that provide Canadians with health statistics at the national, provincial, and territorial levels (Exhibit 6.2). The two principal organizations in the federal government involved in collecting health statistics are Statistics Canada and Health Canada. The third organization, CIHI, collects mostly administrative health data from across the country.

Exhibit 6.1 Key milestones for health statistics in Canada

1991	The National Task Force on Health Information observed deficiencies in existing data systems and concluded a health "information gap" existed. It recommended the creation of a non-governmental institute for health information to address the information gap.
1994	The Canadian Institute for Health Information (CIHI) was established in response to the Task Force recommendation.
1995	Health Canada and Statistics Canada jointly funded CIHI via the Health Information Contribution Program. Under the program, CIHI received $18 million over five years to facilitate and co-ordinate at a national level the development and maintenance of a comprehensive and integrated health information system, and to provide and co-ordinate the provision of accurate and timely information required for establishing sound health policy, effectively managing the Canadian health system, and generating public awareness about factors affecting good health.
1999	CIHI, with the Advisory Committee on Population Health, Health Canada, and Statistics Canada, convened the first National Consensus Conference on Population Health Indicators. A framework was adopted and indicators were identified for initial reporting. The federal Budget provided a $95 million grant to CIHI over four years to work on reporting regularly on the health care system. The Health Information Roadmap Initiative was established as a collaborative effort among CIHI, Statistics Canada, Health Canada, provincial and territorial ministries of health, and other groups.
2000	Health Canada and Statistics Canada renewed the Health Information Contribution Program until 2005. Under the renewed program, CIHI received $13.3 million. First Ministers issued their Communiqué on Health in response to the federal government's provision of additional funds for health care to the provinces and territories. First Ministers made a commitment to regular public reporting. Specifically, the Ministers directed health ministers to • provide comprehensive and regular public reporting by each government on the health programs and services they deliver, on health system performance, and on progress toward priorities; • collaborate on the development of a comprehensive framework using jointly agreed comparable indicator areas such that each government will begin reporting by September 2002. These 14 comparable indicator areas will address health status, health outcomes, and quality of service; and • determine appropriate independent third party verification to certify and analyze health system information.
2001	The Standing Senate Committee on Social Affairs, Science and Technology initiated a study on the role of the federal government in health care. The Committee issued reports in 2001 and 2002. The importance of good-quality health information was re-affirmed. The Prime Minister announced the Commission on the Future of Health Care in Canada. The Commission issued an interim report in February 2002. The interim report commented that "despite recent efforts, good, comparable information on far too many aspects of our health care system—from waiting times, to costs, to treatment outcomes—is woefully lacking." The Commission issued its final report in November 2002. The federal Budget renewed funding (an additional $95 million grant) to CIHI, to be used in conjunction with Statistics Canada, to continue to, among other things, develop common health indicators so that nationwide, comparable information is available.
2002	In September, the federal, provincial, and territorial governments released their health indicators reports.

Exhibit 6.2 Organization of health statistics in the federal government


Statistics Canada
Canadian Cancer Registry
Vital statistics (births, deaths, stillbirths, marriages)
Hospital Person-oriented Database
Canadian Community Health Survey
Other health statistics
Health Canada
Chronic Disease Surveillance Systems, such as National Diabetes Surveillance System
Communicable disease surveillance systems, such as Canadian Tuberculosis Reporting System, Notifiable Disease Reporting System
Injury surveillance
Canadian Institute for Health Information
Discharge Abstract Database/Hospital Morbidity Database
Other databases

6.17 **Statistics Canada.** Statistics Canada's mandate derives mainly from the *Statistics Act*. The Act requires that the Agency collect, analyze, and publish statistical information on the economic, social, and general conditions of the country and its citizens. It is the lead organization for co-ordinating the country's statistical system.

6.18 The Health Statistics Division at Statistics Canada is primarily responsible for health statistics programs. Its mandate is to provide accurate, timely, and relevant information about the health of Canadians and of the health care system. The Health Statistics Division's key activities include running its health statistics programs, producing related products and services (such as the quarterly journal, *Health Reports*), and participating in projects as part of the Health Information Roadmap Initiative. The Division receives data from two sources—administrative records that other organizations provide and its own surveys. In 2001–02 the Division's budget was approximately $8.0 million and it had about 100 full-time employees. In that same year, the Division also received $10.5 million from CIHI in funding for projects under the Health Information Roadmap Initiative.

6.19 **Health Canada.** Health Canada also provides many health statistics. Its national health surveillance systems monitor and collect data on communicable and chronic diseases and injuries. These systems allow it to monitor diseases and injuries on a national level. The provinces and territories and a variety of other federal and non-governmental organizations also contribute data to these systems. As well, Health Canada is responsible for delivering some health services to First Nations and producing statistics on First Nations health.

6.20 **Canadian Institute for Health Information.** Founded in 1994, CIHI is a federally chartered, but independent, not-for-profit corporation. Its mandate is to co-ordinate the development and maintenance of an integrated national approach to health information. CIHI is funded primarily by the provinces and the federal government. When it was created, Statistics Canada transferred several data holdings to CIHI — hospital morbidity statistics, mental health statistics, therapeutic abortion statistics, an annual hospital survey, and a survey of registered nurses. Health Canada also transferred several databases to CIHI. These include the national health expenditures database and the national physician and medical care database. Among other responsibilities, CIHI administers Health Information Roadmap Initiative funds.

Focus of the audit

6.21 This audit is a continuation of our past examination of efforts by Statistics Canada to ensure the quality of national statistics. Previous work included our 1999 audit, Managing the Quality of Statistics, and follow-up work in 2001 on progress made in implementing our recommendations. In our 1999 audit, National Health Surveillance: Diseases and Injuries, we observed weaknesses in Health Canada's systems for collecting surveillance information. In September 2002, we reported that Health Canada had made limited progress toward resolving some of these weaknesses.

6.22 The objectives of this audit were to determine whether

- Statistics Canada has put in place appropriate systems and practices to adequately ensure the quality of its health statistics;
- Statistics Canada, Health Canada, and CIHI have applied quality assurance systems and practices to ensure the accuracy of the health indicators data that they produced for inclusion in the federal, provincial, and territorial health indicators reports; and
- the implementation of the Health Information Roadmap Initiative is consistent with the funding agreement.

6.23 The current audit is timely given the attention that health statistics are now receiving in Canada. With this increased attention, the quality of statistics that Statistics Canada, Health Canada, and others produce is coming under greater scrutiny. Specifically, this audit focussed on the adequacy of Statistics Canada's quality assurance systems and practices for its five health statistics programs that provided health indicators data for the most recent year included in the September 2002 health indicators reports. These programs include Vital Statistics, the Canadian Cancer Registry, the Hospital Person-oriented Database, the Canadian Community Health Survey, and the Health Services Access Survey. The five programs represent the major health statistics databases within the Health Statistics Division. Our work included an examination of how the Agency determines the quality of the data that it receives from other organizations and how it informs users about data quality.

6.24 We also examined the accuracy of data that Statistics Canada and Health Canada produced for inclusion in the federal, provincial, and territorial governments' health indicators reports in September 2002. Some of the indicators for these reports came from two of CIHI's many databases (the

Discharge Abstract Database and the Hospital Morbidity Database). The Office of the Auditor General of British Columbia led a team of legislative auditors—of which we were a member—to examine these databases. Finally, we reviewed two programs, the Health Information Roadmap Initiative and the Health Information Contribution Program, to ensure that the requirements of the agreements were met. Further details on our audit are included at the end of the chapter in About the Audit.

Observations and Recommendations

Quality of Statistics Canada's health statistics

Data quality assurance is well established in Statistics Canada

6.25 Statistics Canada has put in place a wide range of systems and practices to build quality into its statistical programs and to ensure that data quality is a priority. Our 1999 audit noted that the Agency's Quality Assurance Framework, in common with other reputable statistical agencies, approached data quality from the user's perspective. The Framework identifies six characteristics or standards of quality and defines a quality management process for data quality assurance systems and practices (Exhibit 6.3). These characteristics are consistent with our own audit criteria for adequately assuring the quality of statistics. We found that Statistics Canada had used a number of formal mechanisms for assessing data quality but that individual programs had not consistently applied them.

6.26 Our 2001 follow-up to our 1999 audit observed that the Agency had developed a revised formal quality assessment mechanism for all of its statistical programs. Building on the Quality Assurance Framework, Statistics Canada designed the Integrated Program Reporting process as a thorough and rigorous self-assessment of data quality. Exhibit 6.4 summarizes the Integrated Program Reporting process and the Agency's guidelines.

The Agency's health statistics programs meet its data quality standards

6.27 This year's audit found that Statistics Canada's quality assurance systems and practices are sound. The Health Statistics Division followed the Agency's Quality Assurance Framework and produced measures demonstrating that it met the data quality requirements. Wherever the Division identifies quality issues, it undertakes work to address them. The Division reports on the results of its quality assurance practices in its Biennial Program Report and Quadrennial Program Report; however, measures of quality need to be better documented so that internal and external stakeholders will be better informed about whether the data are sound.

6.28 Because Health Statistics Division's surveys are under its direct control, the Division makes necessary improvements to maintain data quality when the need arises. In co-operation with the organizations that provide administrative data to Statistics Canada, the Division is leading work to maintain and improve the quality of the data. We concluded that, with the exception of a component of the Hospital Person-oriented Database, Health

Statistics Division's quality assurance systems and practices result in data that meet Statistics Canada's standards to adequately ensure the quality of its health statistics.

Exhibit 6.3 Statistics Canada's Quality Assurance Framework

Relevance. The relevance of statistical information reflects the degree to which it meets the real needs of clients.

Accuracy. The accuracy of statistical information is the degree to which the information correctly describes the phenomena it was designed to measure.

Timeliness. The timeliness of statistical information refers to the delay between the reference point (or the end of the reference period) to which the information pertains and the date on which the information becomes available.

Accessibility. The accessibility of statistical information refers to the ease with which it can be obtained from the Agency.

Interpretability. The interpretability of statistical information reflects the availability of the supplementary information and metadata necessary to interpret and utilize it appropriately.

Coherence. The coherence of statistical information reflects the degree to which it can be successfully brought together with other statistical information within a broad analytic framework and over time.

The Quality Assurance Framework further describes the following elements of the quality management process, including:

- guidance for managing each of the six dimensions of quality,
- partnership with suppliers,
- recruitment and training, and
- references to appropriate policies and documents.

[illegible]

The Health Statistics Division applies and systematically assesses its data quality procedures through Integrated Program Reporting

6.29 We expected that Statistics Canada would consistently apply its quality assurance systems and practices to all its health statistics programs. We also expected that it would assess the adequacy of these systems and practices for assuring quality in accordance with the Quality Assurance Framework and the guidelines for Integrated Program Reporting.

6.30 **Integrated Program Reporting process assesses quality assurance.** Our audit found that the logic and the design of Statistics Canada's Integrated Program Reporting process are consistent with the Agency's Quality Assurance Framework. This process requires managers to review quality assurance systems and practices in place and the results of those practices. The guidelines require that estimates of the accuracy of statistical programs be examined and that analytical programs disclose the accuracy of their main data sources.

Exhibit 6.4 **Integrated Program Reporting — A Guide for Program Managers**

Statistics Canada bases program reviews on a self-assessment process. The self-assessment process requires that the program manager [illegible] program issues and consult with program [illegible]. The self-assessment and resulting strategic plan are then [illegible].

The integrated process focusses on the following [illegible]

Annual Consolidation of Indicators (ACI)

- annual monitoring of programs,
- involving division based program-oriented performance [illegible] the Corporate Planning Division, and
- including information on data accuracy from the Integrated [illegible]

This information is to be provided to the Chief Statistician [illegible] reference in developing the Agency's performance reports [illegible]

Biennial Program Report (BPR) and Quadrennial Program Report (QPR)

- Once every two years, each program manager [illegible] a report that [illegible] program's performance and identifies strategic issues affecting the program.
- The work will alternate between a biennial program report and a quadrennial program report.
- The six characteristics of quality should be addressed. For example, statistical programs should discuss the degree to which the data correctly estimate or describe the quantities or the characteristics that the program was designed to measure.
- Statistical programs should examine basic accuracy estimates (e.g., coverage error, sampling error, response or imputation rates, [illegible] revisions).
- Analytical programs should discuss the accuracy of their main data sources.

Intended for the Chief Statistician, the report is primarily a tool [illegible] between program managers and senior management but [illegible] to communicate program issues to interested parties outside Statistics Canada. [illegible] is normally in the form of written feedback from the Chief Statistician. In QPR years, the reports are presented to the joint Program Evaluation and [illegible] Committees.

6.31 The Health Statistics [illegible] in February 2002 and [illegible] (see paragraph 6.25 [illegible] Indicators). Both reports provide [illegible] programs and products, including [illegible] are timely. As well, they discuss [illegible] publications and releases. These two [illegible] by senior management committees [illegible] for clarification, where necessary.

6.32 **Biennial and Quadrennial Program reports do not provide sufficient results about data quality.** Although the Health Statistics Division [illegible] applied quality assurance systems and practices to its statistical programs, the

Statistics Division's quality assurance systems and practices result in data that meet Statistics Canada's standards to adequately ensure the quality of its health statistics.

Exhibit 6.3 Statistics Canada's Quality Assurance Framework

Relevance. The relevance of statistical information reflects the degree to which it meets the real needs of clients.

Accuracy. The accuracy of statistical information is the degree to which the information correctly describes the phenomena it was designed to measure.

Timeliness. The timeliness of statistical information refers to the delay between the reference point (or the end of the reference period) to which the information pertains and the date on which the information becomes available.

Accessibility. The accessibility of statistical information refers to the ease with which it can be obtained from the Agency.

Interpretability. The interpretability of statistical information reflects the availability of the supplementary information and metadata necessary to interpret and utilize it appropriately.

Coherence. The coherence of statistical information reflects the degree to which it can be successfully brought together with other statistical information within a broad analytic framework and over time.

The Quality Assurance Framework further describes the following elements of the quality management process, including

- guidance for managing each of the six dimensions of quality,
- partnership with suppliers,
- recruitment and training, and
- references to appropriate policies and documents.

Source: Adapted from Statistics Canada's, Quality Assurance Framework, 2002

The Health Statistics Division applies and systematically assesses its data quality procedures through Integrated Program Reporting

6.29 We expected that Statistics Canada would consistently apply its quality assurance systems and practices to all its health statistics programs. We also expected that it would assess the adequacy of these systems and practices for assuring quality in accordance with the Quality Assurance Framework and the guidelines for Integrated Program Reporting.

6.30 **Integrated Program Reporting process assesses quality assurance.** Our audit found that the logic and the design of Statistics Canada's Integrated Program Reporting process are consistent with the Agency's Quality Assurance Framework. This process requires managers to review quality assurance systems and practices in place and the results of those practices. The guidelines require that estimates of the accuracy of statistical programs be examined and that analytical programs disclose the accuracy of their main data sources.

Exhibit 6.4 Integrated Program Reporting—A Guide for Program Managers

Statistics Canada bases program reviews on a self-assessment process. The self-assessment process requires that the program manager conduct an examination of program issues and consult with program constituents as well as committees. The self-assessment and resulting strategic plan are then reviewed by senior management.

The integrated process focusses on the following elements:

Annual Consolidation of Indicators (ACI)

- annual monitoring of programs,
- involving division-based program-oriented performance indicators compiled by the Corporate Planning Division, and
- including information on data accuracy from the Integrated Meta-database.

This information is to be provided to the Chief Statistician and is to be used as a reference in developing the Agency's performance reports to Parliament.

Biennial Program Report (BPR) and Quadrennial Program Report (QPR)

- Once every two years, each program manager is to submit a report that reviews the program's performance and identifies strategic issues affecting the program.
- The work will alternate between a biennial program report and a quadrennial program report.
- The six characteristics of quality should be addressed. For example, statistical programs should discuss the degree to which the data correctly estimated or describe the quantities or the characteristics that the program was designed to measure.
- Statistical programs should examine basic accuracy estimates (e.g., coverage error, sampling error, response or imputation rates, or size of revisions).
- Analytical programs should discuss the accuracy of their main data sources.

Intended for the Chief Statistician, the report is primarily a tool for communication between program managers and senior management but will also be used to communicate program issues to interested parties outside Statistics Canada. Follow-up is normally in the form of written feedback from the Chief Statistician. In QPR years, the reports are presented to the joint Program Evaluation and Corporate Planning Committees.

Source: Adapted from Statistics Canada, *Integrated Program Reporting: A Guide for Program Managers*, 2001

6.31 The Health Statistics Division completed its Biennial Program Report in February 2000 and its Quadrennial Program Report in November 2001 (see paragraph 6.75 for our observations on the Annual Consolidation of Indicators). Both reports provide valuable information on the Division's programs and products, including information on challenges that its programs are facing. As well, they discuss some data quality issues for major statistical publications and releases. These two program reports were formally reviewed by senior management committees, who then provided comments and asked for clarification, where necessary.

6.32 **Biennial and Quadrennial Program reports do not provide sufficient results about data quality**. Although the Health Statistics Division applied quality assurance systems and practices to its statistical programs, the

Biennial and Quadrennial Program reports did not provide sufficient specific results of data quality measures, as required by the guidelines. Therefore, we could not reach a conclusion on whether the Division's programs were meeting the Agency's data quality assurance systems and practices. The lack of specific measures of data quality in the reports limited the Division's ability to demonstrate the extent to which it met the data quality requirements. It also had an impact on the Division's capacity to direct senior management's attention to areas that needed improvement.

6.33 As a result, the two program reports did not provide the necessary information to allow us to reach a conclusion on the adequacy of data quality assurance systems and practices. We therefore did some additional work to determine whether this problem was due to poor documentation in the reports or to actual shortcomings in data quality assurance. We found that Statistics Canada did more quality assurance work than it documented in its two program reports.

6.34 **Recommendation.** Statistics Canada should provide better documentation and references to more complete documentation of the results of its data quality systems and practices in the Biennial Program Report and the Quadrennial Program Report.

Agency's response. Agreed. Specific data quality reports will be cited in the Biennial Program Report and the Quadrennial Program Report to support important program activities. Statistics Canada will continue to enhance the utility of the Integrated Program Reporting process through regular review.

Statistics Canada is leading work to strengthen integrity of vital statistics data

6.35 Statistics Canada uses the results of quality assurance systems and practices documented in program reports, in addition to the results of other work, to manage the quality of health statistics it produces. We found that the Agency applied quality assurance systems and practices to its vital statistics data and that the data met the Agency's data quality standards. In addition to what it included in the program reports, Statistics Canada measured data quality and identified some areas where the integrity of the data can be strengthened. In partnership with the provinces and territories, Statistics Canada is leading work to improve the integrity of vital statistics data across Canada.

6.36 Due to legal reporting requirements, the registration of vital statistics—births, deaths, and stillbirths—is virtually complete. The provinces and territories are responsible for collecting the statistics, editing them, and sending them to Statistics Canada. The Agency then collects and processes the vital statistics data. Statistics Canada has undertaken work to measure data quality, including verifying problematic records, carrying out numerous edits and imputations, and tracking their potential impact on data quality. It produces reports on the capture, editing, and quality control of data. The Agency also takes an annual sample of records and independently verifies them with the original registrations. It has documented the sources and causes of deficiencies and is actively working to correct them.

6.37 Statistics Canada works with individual jurisdictions on the quality of their data. It also works to improve data quality through its participation in the Vital Statistics Council for Canada, which is a partnership between provincial and territorial vital statistics registrars and Statistics Canada. The Council developed a business plan for 1999–2004 that commits to improving national standards in areas such as data definition, collection, and reporting. In addition, as part of the Health Information Roadmap Initiative, Statistics Canada is working on a project to improve the quality of the data and enhance the capacity to use these data in developing health outcome information.

Statistics Canada is working with provincial and territorial cancer registries to improve data quality

6.38 We found that Statistics Canada's application of its quality assurance systems and practices to Canadian Cancer Registry data met its standards for data quality. The Agency measured data quality, identified ways to make improvements, and is working with provincial and territorial cancer registries to implement these improvements.

6.39 The Canadian Cancer Registry contains data collected by provincial and territorial cancer registries. Data files are sent to Statistics Canada for edit checks, elimination of duplicate and redundant files, entering into a national registry, and analysis. Statistics Canada has incorporated a wide range of edit checks to ensure the completeness and quality of the data. It also regularly produces a set of quality control reports. These are shared with the provincial and territorial registries to improve overall data quality and to target areas that need improvement.

6.40 Statistics Canada undertakes other work to promote the quality of its data. It sponsors an annual workshop on coding issues concerning the International Classification of Diseases. It also commissions studies on data quality to address specific concerns. Under the Health Information Roadmap Initiative, Statistics Canada is leading joint work with provincial and territorial partners on a project that includes assessing the completeness and quality of existing information.

6.41 **Recommendation.** Statistics Canada should continue to work with the provinces and territories to improve the quality of health statistics databases.

Agency's response. Agreed.

Additional data quality work is needed for the Hospital Person-oriented Database

6.42 The objective of person-oriented information is to analyze and describe how Canadians fare as a result of their contact with the health care system (that is, patient outcomes). The Hospital Person-oriented Database is created by transforming hospital morbidity data from being event-oriented (that is, hospital visits) to person-oriented (that is, all hospital visits by the same person). We found that Statistics Canada had not formally determined the quality of the hospital morbidity data received from CIHI (paragraphs 6.62

to 6.64). Therefore, we were unable to reach a conclusion on whether the Hospital Person-oriented Database met the Agency's data quality standards.

6.43 The database combines records of hospital visits to create information that can be used to track a person's health outcomes. Examples of person-oriented information that address patient outcomes include the 365-day net survival rate for acute myocardial infarction and the 180-day net survival rate for stroke.

6.44 The two program reports described earlier state that reports are generated to assess the quality of the linkage on individuals. As well, under the Health Information Roadmap Initiative, Statistics Canada is conducting work as part of the Person-Oriented Information Project. This is intended to increase its capacity to combine health care data and to use this capacity to provide information on the health of Canadians as well as on the performance of the health care system.

6.45 Nonetheless, the program reports do not refer to specific data quality measures for the Hospital Person-oriented Database. The reports state that the Agency produces a set of quality control reports regularly to monitor the quality of the main person-oriented data items of the hospital morbidity files. We found that these quality control reports focussed only on very specific quality issues and on instances where transforming hospital morbidity data yielded errors. The Agency did not undertake other work to determine the overall quality of the data it received from this source.

The Canadian Community Health Survey meets data quality standards

6.46 Statistics Canada has applied a comprehensive set of data quality assurance systems and practices to the Canadian Community Health Survey. The results were used in managing data quality, and we found that the survey met the Agency's standards for data quality.

6.47 The Canadian Community Health Survey is a new biennial survey. It provides data on health determinants, health status, and health system use to address information needs at the national, provincial, territorial, and regional levels. Statistics Canada released its first survey data in May 2002.

6.48 At the outset of this audit, Statistics Canada agreed that it would carry out a self-assessment of the quality management systems and practices applied to the survey. This was because the survey was still in progress at the time when the Health Statistics Division prepared its Biennial and Quadrennial Program reports.

6.49 The self-assessment concluded that this survey is well supported by a comprehensive quality assurance program. This program maintains data quality through extensive consultations, testing and monitoring, and other data quality assurance activities. Our further examination found that Statistics Canada had

- undertaken appropriate consultations to help ensure the relevance of the statistics to users,

- developed and tested much of the survey tool through use in a previous survey,
- yielded reliable estimates as a result of the sample size and method at the level of health regions,
- put in place a solid infrastructure to collect the data,
- carried out quality assurance reporting monthly, and
- released the data on a timely basis.

The Health Services Access Survey meets data quality standards

6.50 In 2002 Statistics Canada conducted the Health Services Access Survey, a supplement to the Canadian Community Health Survey, to provide some additional data for the September 2002 health indicators reports. It used the same quality assurance systems and procedures as the Canadian Community Health Survey. We concluded that the Health Services Access Survey had adequate quality assurance systems and practices to ensure the quality of the data.

Getting to good-quality statistics

6.51 Although Statistics Canada's health programs meet data quality assurance standards, there is always room for further improvement. Quality in statistics is not an absolute standard but is relative to the elements of the Quality Assurance Framework and to the intended use of the statistics. Implementing a quality assurance framework requires continuous work, monitoring, review, and adjustment. Statistics Canada is very concerned about data quality. It appropriately identifies areas for improvement and takes steps to act on them. Further, one of the underlying principles of Statistics Canada's Quality Assurance Framework is that continuous work is necessary to ensure that data quality is maintained.

6.52 We found that the quality assurance systems and practices in place meet the standards of Statistics Canada's Quality Assurance Framework. These standards seek to ensure, among other things, that the data are accurate. We found that the data are accurate for the purpose of reporting at the jurisdictional level (national, provincial, and territorial figures for the September 2002 health indicators reports). However, users focussing on data at a lower or more detailed level (for example, an incidence rate for a disease within a regional health authority) need to be aware that any improvements in data quality made by Statistics Canada at the provincial and territorial levels may not lead to data accuracy at lower levels.

Statistics Canada's disclosure to users of quality of health statistics is uneven

6.53 All statistics are, to some extent, estimates of the reality they seek to convey. Therefore, they have to be used with full awareness of their strengths and limitations. Statistics Canada's policy on informing users of data quality and methodology (Exhibit 6.5) is to provide users with the information they need to determine whether the statistics fit their purposes. Our 1999 audit found that the Agency's implementation of the policy was inconsistent. Our

[illegible]

Exhibit 6.5 Key elements of policy on informing users of data quality

Key elements

- Statistics Canada will make available to users indicators of the quality of data it disseminates and descriptions of the underlying concepts and methodology.
- Statistical products will be accompanied by, or make specific reference to, documentation on quality and methodology.
- Documentation on quality and methodology will conform to the standards and guidelines issued under this policy.

Mandatory documentation requirements

Specific standards for documentation of quality [illegible] data accuracy:

- a statement of the key data accuracy issues;
- data accuracy measures of coverage, or at least a coverage rate;
- estimates of sampling errors for key characteristics; and
- response rate and imputation rate.

6.54 [illegible] Exhibit 6.5.

6.55 [illegible] Integrated Meta Data Base [illegible] policy [illegible]

6.56 **Policy inconsistently applied.** [illegible] completed an internal audit [illegible] internal audit examined a sample [illegible] surveys included in the Integrated Meta Data Base. The internal audit [illegible] that Statistics Canada [illegible] and that program staff had [illegible] by the policy. As well, neither current [illegible] were included in the sample for the internal audit. [illegible]

2001 follow-up report noted that Statistics Canada had taken steps to address our observations. It had begun to create a central source of information to support internal reporting and external disclosure of the quality of statistics. Statistics Canada refers to this as an Integrated Meta-database. The Agency introduced the Integrated Meta-database in 2000 and planned that it would have information on the data quality, concepts, and underlying methodology of each of its databases. This was to ensure a central source of information to support both consistent and effective internal reporting and external disclosure of the quality of the Agency's statistics.

Exhibit 6.5 Key elements of policy on informing users of data quality

Key elements

- Statistics Canada will make available to users indicators of the quality of data it disseminates and descriptions of the underlying concepts and methodology.
- Statistical products will be accompanied by or make explicit reference to documentation on quality and methodology.
- Documentation on quality and methodology will conform to standards and guidelines issued under this policy.

Mandatory documentation requirements

Specific standards for documentation of quality include the following requirements for data accuracy:

- a statement of the key data accuracy issues;
- data accuracy measures of coverage, or at least a coverage rate;
- estimates of sampling errors for key characteristics; and
- response rate and imputation rate.

Source: Adapted from Statistics Canada, Policy on informing users of data quality

6.54 We expected that, as specified by the policy, individual statistical programs would appropriately inform users about data quality and methodology when data are disseminated.

6.55 We found that the Health Statistics Division used the policy on informing users of data quality and methodology; however, the application of the policy was not consistent. Not all of the policy requirements were being adhered to in disclosing the quality of health statistics. The Integrated Meta-database provided some information on data quality but less than the policy requires.

6.56 **Policy inconsistently applied.** In 2001–02, Statistics Canada completed an internal audit of Agency-wide compliance with the policy. This internal audit reviewed samples of recent statistical products as well as the surveys included in the Integrated Meta-database. The internal audit found that Statistics Canada products did not have a standardized message to users and that program staff had difficulty determining some of what was required by the policy. As well, neither current health surveys nor current databases were included in the sample for the internal audit. In light of that audit, we examined whether those health programs now included in the Integrated Meta-database had appropriately notified users about data quality.

6.57 **Integrated Meta-database has incomplete information on health statistics.** We found that, in all cases, the information in the Integrated Meta-database was less than required by the policy. Key measures of data quality were missing. Overall, the database did not provide a complete picture of the quality of health program data.

6.58 The lack of complete information on quality measures is recognized by the Standards Division, the unit within Statistics Canada responsible for maintaining the database. Division management indicated that it plans to improve the database by developing templates tailored to the specific needs of some program areas. Management recognized that a new approach is needed to help program managers maintain current information in the database.

6.59 **Recommendation.** Statistics Canada should ensure that the information in the Integrated Meta-database on data quality of health programs is complete.

Agency's response. Agreed. Statistics Canada will continue its efforts to improve the availability of complete and up-to-date information on the data quality of health programs through the Integrated Meta-database.

Insufficient monitoring of the quality of statistics supplied by the Canadian Institute for Health Information

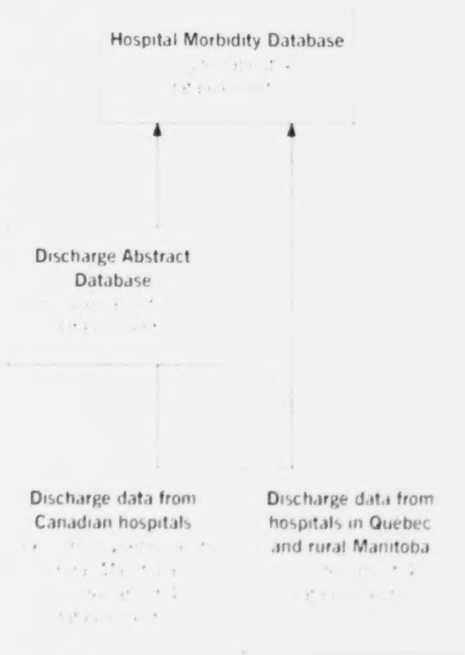
6.60 Survey data and administrative data are substantially different in the degree of control that Statistics Canada has over quality assurance (paragraph 6.28). The quality of surveys conducted by the Agency is within its direct control. By contrast, the Agency does not have direct control over the management of the quality of administrative data collected by other organizations. Data from CIHI fall under this latter category. We expected that Statistics Canada would determine the quality of data from CIHI.

6.61 Although Statistics Canada has taken action to address concerns about some CIHI data, it has not taken steps to formally determine the quality of hospital morbidity data received (Exhibit 6.6). This concerns us because these data are used to construct health indicators and we could not conclude whether the data are accurate.

6.62 Statistics Canada's program reports state that the Agency maintains a data quality role for databases transferred to CIHI. They also state that, prior to release, the Agency examines the completeness of data, performs trend analysis, and does selective editing of records. The reports point to an extensive 1998 study that Statistics Canada conducted on data quality of the Annual Hospital Survey. As well, although Statistics Canada transferred the Residential Care Survey to CIHI, the survey was returned to Statistics Canada because of serious shortcomings in data quality.

6.63 However, we noted that Statistics Canada took an informal approach to the quality of hospital morbidity data from CIHI. We found little information on data quality for the two relevant databases. CIHI completed

Exhibit 6.6 Overview of the Discharge Abstract Database and the Hospital Morbidity Database


Hospital Morbidity Database
Discharge Abstract Database
Discharge data from Canadian hospitals
Discharge data from hospitals in Quebec and rural Manitoba

Discharge Abstract Database

The Canadian Institute for Health Information (CIHI) receives data on hospital discharges from all hospitals in every province and territory, except Quebec and parts of Manitoba. Coverage represents roughly 75 percent of all hospital inpatient discharges in Canada.

The database contains more than 100 demographic, administrative, and clinical data elements for hospital discharges (inpatient acute, chronic, rehabilitation) and day surgeries.

Hospital Morbidity Database

Data are downloaded from the Discharge Abstract Database for participating hospitals. Data files for the remaining hospitals are submitted by the appropriate provincial or territorial ministry of health. Data are received from general and allied special hospitals, including acute care, convalescence, and chronic facilities (except in Ontario). Data do not include any outpatient services in any hospital or services in psychiatric hospitals.

This database contains clinical and demographic data on primary diagnosis, operations, admission date, discharge condition, total days stayed, and age and gender.

The purpose of the Hospital Morbidity Database is to:

- collect, process, and analyze diagnoses and procedures for all hospital discharges;
- facilitate hospital, regional, provincial/territorial, and national comparative reporting;
- support management decision making at the hospital, regional, and provincial/territorial levels;
- provide data to federal departments such as Statistics Canada; and
- support related approved analysis and research.

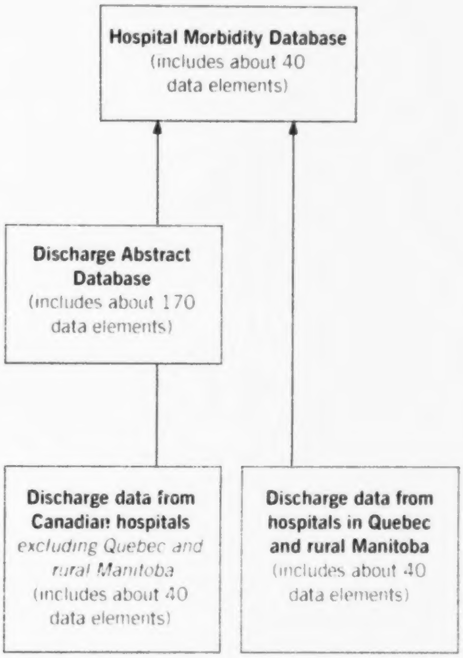
the first part of a data re-abstraction study of the Discharge Abstract Database, from which the Hospital Morbidity Database is derived. It published a summary of the study results. Although a more detailed version of this document was available, this was not requested by Statistics Canada.

6.64 Data from these two databases are used extensively to monitor the use of acute care health services and to conduct analyses of health conditions and injuries. The data are also increasingly being used to track patient outcomes and are a major contributor to numerous reports and publications. Given their extensive use, the issue of data quality requires close attention.

6.65 **Recommendation.** Statistics Canada should make a regular, formal determination of the quality of the hospital morbidity data it receives from the Canadian Institute for Health Information (CIHI).

Agency's response. Agreed. Statistics Canada will work with CIHI to ensure regular reporting of data quality of the Hospital Morbidity Database.

Exhibit 6.6 Overview of the Discharge Abstract Database and the Hospital Morbidity Database


Hospital Morbidity Database
(includes about 40 data elements)
Discharge Abstract Database
(includes about 170 data elements)
Discharge data from Canadian hospitals
excluding Quebec and rural Manitoba
(includes about 40 data elements)
Discharge data from hospitals in Quebec and rural Manitoba
(includes about 40 data elements)

Discharge Abstract Database

The Canadian Institute for Health Information (CIHI) receives data on hospital discharges from all hospitals in every province and territory, except Quebec and parts of Manitoba. Coverage represents roughly 75 percent of all hospital inpatient discharges in Canada.

The database contains more than 100 demographic, administrative, and clinical data elements for hospital discharges (inpatient acute, chronic, rehabilitation) and day surgeries.

Hospital Morbidity Database

Data are downloaded from the Discharge Abstract Database for participating hospitals. Data files for the remaining hospitals are submitted by the appropriate provincial or territorial ministry of health. Data are received from general and allied special hospitals, including acute care, convalescence, and chronic facilities (except in Ontario). Data do not include any outpatient services in any hospital, or services in psychiatric hospitals.

This database contains clinical and demographic data on primary diagnosis, operations, admission date, discharge condition, total days stayed, and age and gender.

The purpose of the Hospital Morbidity Database is to

- collect, process, and analyze diagnoses and procedures for all hospital discharges;
- facilitate hospital, regional, provincial/territorial, and national comparative reporting;
- support management decision making at the hospital, regional, and provincial/territorial levels;
- provide data to federal departments such as Statistics Canada; and
- support related approved analysis and research.

Source: Office of the Auditor General of Canada and Canadian Institute for Health Information

the first part of a data re-abstraction study on the Discharge Abstract Database, from which the Hospital Morbidity Database is derived. It published a summary of the study and, although a more detailed version of this document was available, this was not requested by Statistics Canada.

6.64 Data from these two databases are used extensively to monitor the use of acute care health services and to conduct analyses of health conditions and injuries. The data are also increasingly being used to track patient outcomes and are a major contributor to various reports and publications. Given their extensive use, the issue of data quality requires close attention.

6.65 **Recommendation.** Statistics Canada should make a regular, formal determination of the quality of the hospital morbidity data it receives from the Canadian Institute for Health Information (CIHI).

Agency's response. Agreed. Statistics Canada will work with CIHI to ensure regular reporting of data quality of the Hospital Morbidity Database.

6.66 Accountability requirements for the Health Information Contribution Program are not met. Following the creation of CIHI in 1994, Statistics Canada transferred several health statistics programs to CIHI. Under the five-year Health Information Contribution Program Agreement between the two organizations, Statistics Canada transferred $4.75 million between 1994–95 and 1999–2000. These funds accompanied the transfer of responsibility to CIHI for several surveys—mental health, therapeutic abortions, morbidity data, and the annual hospital survey. It should be noted that Statistics Canada did not formally delegate authority to CIHI under the *Statistics Act* to do this work; the work was done under the contribution agreement.

6.67 The contribution agreement outlines accountability requirements for the Health Information Contribution Program. These include the requirement for CIHI to make information on databases available to Statistics Canada and to provide Statistics Canada with a program evaluation and annual audit reports.

6.68 CIHI provided the annual audit reports to Statistics Canada through the Agency's representation on the CIHI Board. The agreement specified that CIHI provide a program evaluation in 1997–98 to Statistics Canada on the first three full years of its operation (and every three years thereafter, as long as CIHI receives funding under the agreement). This evaluation was to review and assess the value of the key objectives and results achieved, including impacts achieved in areas targeted by CIHI.

6.69 Instead of a formal evaluation, a consulting firm completed an external review for CIHI in 1997. It addressed issues related to the CIHI mandate, governance, and operations; however, it did not cover the key objectives and results achieved. Statistics Canada renewed the contribution agreement in 2000 for another five years ($2.8 million) without asking for a second evaluation, as required by the agreement. In addition, the renewed contribution agreement required CIHI to complete an evaluation framework for its overall activities and forward it to Statistics Canada by the end of 2000–01. However, Statistics Canada did not ensure that it was forwarded. We found that the Agency did not take action to ensure that the accountability provisions of the contribution agreement were respected.

6.70 Health Canada also contributed funds to CIHI under a Health Information Contribution Program contribution agreement. The Department transferred $13.4 million and several databases to CIHI between 1994–95 and 1999–2000. As was the case with Statistics Canada, Health Canada renewed the agreement for an additional five years in 2000–01 ($10.4 million) without ensuring a program evaluation was done. As well, the renewed contribution agreement required CIHI to complete an evaluation framework for its overall activities and forward it to Health Canada by the end of 2000–01. However, Health Canada did not ensure that it was forwarded. We found that the Department did not take action to ensure that the accountability provisions of the contribution agreement were respected.

6.71 Recommendation. Statistics Canada and Health Canada should formally monitor the requirements of their respective Health Information Contribution Program contribution agreements and ensure that requirements are met.

Statistics Canada's response. Statistics Canada has received and reviewed an evaluation framework for the contribution agreement with the Canadian Institute for Health Information. Plans are currently under way to undertake a formal evaluation.

Health Canada's response. Health Canada has already considerably increased its capacity to monitor the contribution agreements and improve its interaction with the Canadian Institute for Health Information. In addition, an evaluation framework has been jointly developed, by CIHI, Statistics Canada, and Health Canada, to be used in evaluating the contribution agreement. This framework will be used to guide a joint evaluation of the Health Information Contribution Program and the Health Information Roadmap Initiative to be completed by September 2003.

Limited reporting to Parliament on the quality of health statistics by Statistics Canada

6.72 In our 1999 audit we noted that, while the quality of statistics figured prominently in Statistics Canada's commitments to Parliament for results, its annual Departmental Performance Report provided limited information on the quality of its statistics. We recommended that this information be improved.

6.73 We found that Statistics Canada has restructured its Performance Report since our 1999 audit to address our recommendation. It now reports performance based on its Quality Assurance Framework. Several mission-critical statistical products are systematically reported on for relevance, accuracy, timeliness, accessibility, interpretability, and coherence.

6.74 We noted that the Health Statistics Division has undergone significant changes over the last few years to address health information needs; however, there is little mention of this in the Agency's performance reports for the periods ending 31 March 2000 and 31 March 2001. The Division has expanded in the last several years, in part because of Roadmap Initiative funding. Statistics Canada received about $40 million over four years (1999–2000 to 2002–03) to enhance or improve the quality of health statistics, including the Canadian Community Health Survey, Vital Statistics, and Canadian Cancer Registry. The performance reports do not identify accomplishments related to this increased funding; nor do they identify the Agency's partners in the production of health statistics at the federal, provincial, and territorial levels.

6.75 Annual Consolidation of Indicators not done. The Agency's 2000–01 guidelines for Integrated Program Reporting stated that the Annual Consolidation of Indicators of performance would be completed in the same year. Although we found that most of the information was available in Statistics Canada, it had not completed the consolidation work for the Health Statistics Division. Corporate Planning Division officials told us that this was because the full implementation of Integrated Program Reporting needed substantial time and effort and that the Annual Consolidation of Indicators component would be implemented over time. This represents a setback because these indicators provide a source of performance information for the Agency's Performance Report.

6.76 **Recommendation.** Statistics Canada should provide information in its Departmental Performance Report on the key results of its work on health statistics, including work undertaken as part of the Health Information Roadmap Initiative.

Agency's response. Agreed. Statistics Canada will include the results of its work on health statistics in its annual Departmental Performance Report, when appropriate.

Quality of Health Canada's health statistics

Limited application of data quality practices to health statistics

6.77 Health Canada collects data on communicable and chronic diseases, as well as on injuries, through its national surveillance systems. Our examination of Health Canada surveillance systems was limited to the three databases that provided data for the September 2002 health indicators reports—the Notifiable Disease Reporting System, the National Diabetes Surveillance System, and the Canadian Tuberculosis Reporting System. These three databases rely on administrative data provided voluntarily by the provinces and territories.

6.78 We expected that Health Canada would have applied quality assurance systems and practices to these three databases. We also expected that the Department would use the results of quality assurance systems and practices in managing quality and reporting performance.

6.79 We found that Health Canada does not have an overall quality assurance framework for its surveillance systems. Although the Department does conduct some quality assurance work, it is primarily ad hoc and varies by surveillance system. Quality assurance mechanisms are weak and do not result in concrete quality measures. It is therefore not possible to conclude whether the surveillance data are accurate.

6.80 We reviewed the work undertaken by Health Canada on the three surveillance systems to ensure good-quality statistics. The Department does some work to improve data quality, including both automated and manual checks for the data it receives from provinces and territories. These include checks to ensure interprovincial consistency of data coding. Health Canada sends data with errors back to the source jurisdictions to confirm the accuracy of the data. As well, because not all jurisdictions use the same version of the International Classification of Diseases codes, the Department does some coding conversions to ensure that the integrity of its databases is maintained with one standardized coding system.

6.81 However, Health Canada has no systematic procedure for edit checks and those that are done are ad hoc rather than in response to a formal policy requirement. As well, the Department has not established standards for data quality. Nor has it measured the quality of the data, particularly in terms of completeness and accuracy. Therefore, Health Canada cannot determine the accuracy of its data for these three surveillance systems.

6.82 Our observations reflect those made in our September 2002 Report, Chapter 2, National Health Surveillance. The chapter noted that Health Canada had made limited progress toward resolving weaknesses identified in our 1999 audit. It also noted that many surveillance systems still lack timely, accurate, and complete information on diseases.

6.83 **Recommendation.** Health Canada should adopt, in collaboration with the provinces and territories, a common quality assurance framework and standards that would outline quality requirements for its health surveillance systems.

Health Canada's response. Health Canada will work with the provinces and territories to develop a quality assurance framework and standards for its health surveillance systems. These standards will make explicit what heretofore have been informal procedures and will make it easier to assess the completeness and accuracy of the surveillance data received from the provinces and territories.

Verifying the accuracy of health indicators data

6.84 In September 2000, First Ministers issued their Communiqué on Health that committed health ministers to report regularly on health status, health outcomes, and the performance of publicly funded health services (Exhibit 6.1). The Conference of Deputy Ministers of Health approved 67 indicators against which jurisdictions were to report. The First Ministers directed health ministers to determine appropriate, independent, third party verification of the accuracy of the health indicators data.

Work undertaken by the Canadian Council of Legislative Auditors

6.85 In the same way that it is important for jurisdictions to achieve comparable reporting on indicators, it is also important that health indicators reports be verified in a comparable manner. The Canadian Council of Legislative Auditors, made up of provincial auditors general and the Auditor General of Canada, established the Health Indicators Study Group. This group assists legislative audit offices in their respective responsibilities related to the First Ministers' agreement. Legislative audit offices across the country were nominated by their governments to do the verification.

6.86 Health Canada was tasked with compiling the federal health indicators report. We accepted the Department's request for us to undertake third party verification of the report. As the legislative auditors for Nunavut, the Northwest Territories, and Yukon, we also verified their health indicators reports upon their request.

6.87 Members of the Health Indicators Study Group worked with their respective health ministries to reach an agreement on the form the verification would take. Although the overall goal of the Group was to provide audit-level assurance, this was not possible in all cases. In some cases, external auditors provided audit-level assurance. In other cases, they were engaged to perform specified auditing procedures (see the Appendix).

6.88 Health indicators data came from Statistics Canada, Health Canada, CIHI, and provincial and territorial databases. Statistics Canada and, to a lesser extent, Health Canada and CIHI, provided data for the majority of health indicators. We provided provincial audit offices with the results of our audit of the quality of statistics produced by Statistics Canada and Health Canada that were relevant to their third party verification work. We also participated in work led by the Office of the Auditor General of British Columbia on statistics produced by CIHI for seven of the health indicators. The legislative audit offices used the results of this examination of CIHI for their verification work.

6.89 We expected that, in producing data for health indicators reports, a determination of the quality of data received from other organizations would be made, data elements would be accurately extracted from the data source, definitions and formulae would be correctly applied, calculations and presentations would be free of errors, and quality limitations would be adequately disclosed.

6.90 We found that Statistics Canada databases met the Agency's standards for quality assurance, with the exception of the Hospital Person-oriented Database, which relies on CIHI data (paragraphs 6.35 to 6.50). The data were accurately extracted from the data source, definitions and formulae were correctly applied, and calculations and presentations were free of errors.

6.91 We found that Health Canada's quality assurance systems and practices were inadequate and did not ensure accurate data (paragraphs 6.77 to 6.82). The Department was unable to demonstrate how complete or accurate its data were. We were therefore unable to form an opinion on the accuracy of these data.

6.92 In the work led by the Office of the Auditor General of British Columbia to determine the accuracy of the data CIHI provided for the September 2002 health indicators reports, the required data were drawn from both the Discharge Abstract Database and the Hospital Morbidity Database. As a result of this work, it was concluded that documentation on the CIHI quality assurance process for the systems that support the indicators was inadequate. As well, a three-year re-abstraction study, which will provide information on the quality of the input data, will not be completed for another two years. Therefore, it was not possible to form an opinion on the accuracy of the specific data provided by CIHI for the health indicators reports.

Meeting health information needs

6.93 The importance of developing health indicators has been recognized for several years. In its 1999 Budget, the federal government identified a number of specific priority projects and activities in the health information field and allocated $95 million over four years toward their completion. CIHI was expected to work with provincial and territorial governments to build consensus over selecting which health indicators to report, developing standards for data, filling key gaps in information, and building capacity to analyze data and disseminate information to those who need it. In its 2001 Budget, the federal government announced that it would provide a further $95 million to CIHI, to be used in co-operation with Statistics Canada. This included funding for developing common health indicators so that nationwide, comparable information would be available to Canadians.

6.94 The grants were made by Health Canada to CIHI. Under the terms of the 1999 grant, Health Canada was to receive an annual report from CIHI. It was to include a statement of CIHI's objectives for that year under the Health Information Roadmap Initiative and the extent to which CIHI met those objectives. As well, CIHI was to develop an evaluation plan in 1999–2000, to be provided to the Minister of Health, and it was to keep records to facilitate an evaluation of the grant.

6.95 We expected that the Roadmap Initiative grant would be monitored by signatories according to responsibilities outlined in agreements, including whether work had been undertaken as outlined in the agreements.

Health Canada's monitoring of the Health Information Roadmap Initiative is weak

6.96 We found that Health Canada did not actively monitor the Health Information Roadmap Initiative to ensure that CIHI complied with the requirements outlined in the grant. In particular, the Department did not ensure that CIHI submitted an evaluation plan. We reviewed CIHI's annual Roadmap Initiative reports to determine if they provided information on the extent to which Roadmap objectives were achieved. Although the reports describe activities that took place, there is little information on the extent to which they contributed to the achievement of Roadmap objectives. We found that no formal evaluation was undertaken and submitted to Health Canada before the grant was renewed for an additional $95 million. Finally, we found that accountability arrangements were unclear—that funding and reporting relationships did not facilitate clear accountability relationships. Overall, Health Canada is not in a position to know if implementation of the Roadmap Initiative is consistent with the funding agreement.

6.97 **Recommendation.** Health Canada should monitor the Health Information Roadmap Initiative in accordance with the grant requirements to ensure that the requirements are met.

Health Canada's response. Health Canada and CIHI have already jointly developed an evaluation framework. This framework will be used to conduct a formal third party evaluation of the Health Information Roadmap Initiative to be completed by September 2003, in accordance with the timelines laid out in the funding agreement. There has been an ongoing and comprehensive flow of information between CIHI and Health Canada. This information flow and the accompanying dialogue provided a solid basis for the renewal of the Health Information Roadmap Initiative.

Conclusion

6.98 There are no absolute standards for the quality of statistics. Implementing sound data quality practices requires continuous work, monitoring, review, and adjustment. There is always room to improve the quality of statistics.

6.99 Our audit found that Statistic's Canada's quality assurance systems and practices are sound. Health Statistics Division has applied quality assurance procedures to its statistical programs, has undertaken work resulting in measures demonstrating that its programs meet quality standards, and has completed reviews of its quality assurance practices. However, we did find some weaknesses in Statistics Canada's documentation of data quality achieved.

6.100 Statistics Canada has a policy for informing users of data quality and methodology. However, Health Statistics Division's application of the policy is uneven and references to the quality of its health statistics in the Agency's Integrated Meta-database are incomplete.

6.101 Although Statistics Canada takes steps to formally determine the quality of data it receives from most external sources, it does not take steps to formally determine the quality of hospital morbidity data from CIHI. This concerns us because these data are used to construct health outcomes data.

6.102 We found that Statistics Canada's application of quality assurance systems and practices adequately ensured the accuracy of the health indicators data produced for the September 2002 federal, provincial, and territorial health indicators reports.

6.103 For Health Canada, we found that participation on the part of provinces and territories in surveillance databases is voluntary and there is a lack of formal federal provincial territorial agreements on data sharing, data standards, and data definitions. The quality assurance systems and practices for these databases are inadequate to ensure the accuracy of the data. Health Canada stated in the federal health indicators report that improvements in data quality are needed. However, we were unable to reach a conclusion on the accuracy of the Health Canada data.

6.104 Audit work led by the Office of the Auditor General of British Columbia found that documentation is inadequate on the quality assurance process for the systems and practices that CIHI uses to provide data for seven health indicators for the September 2002 health indicators reports. As well, the three-year re-abstraction study, which will provide information on the quality of the input data, will not be completed for another two years. Therefore, it was not possible to form an opinion on the accuracy of the specific data provided by CIHI for the health indicators reports.

6.105 The federal government has recognized the importance of developing health indicators to meet information needs. Health Canada needs to actively monitor the Health Information Roadmap Initiative to ensure that accountability requirements are met and that implementation is consistent with the funding agreement.

6.106 Overall, the audit found that Statistics Canada played a key role in providing good-quality statistics that contribute to an informed public debate on health issues and, more specifically, to the September 2002 health indicators reports. Our audit work provides assurance on the quality of these statistics.

About the Audit

Objectives

The objectives of the audit were to determine whether

- Statistics Canada has put in place appropriate systems and practices to adequately ensure the quality of its health statistics;
- Statistics Canada, Health Canada, and the Canadian Institute for Health Information have applied quality assurance systems and practices to ensure the accuracy of the health indicators data that they produced for inclusion in the federal, provincial, and territorial health indicators reports; and
- the implementation of the Health Information Roadmap Initiative is consistent with the funding agreement.

Scope and approach

The audit focussed on Statistics Canada's quality assurance systems and practices as they relate to the Agency's health statistics programs. The audit team carried out work to determine the adequacy of quality assurance work undertaken on health statistics programs. As well, Statistics Canada and the audit team agreed that the Agency would do a self-assessment of data quality for a product, the Canadian Community Health Survey, which was not included in its quality reviews to date. The audit team subsequently audited the self-assessment.

The audit examined how Statistics Canada determined the quality of data received from other organizations and its compliance with its policy on informing users of data quality and methodology. The audit also examined the accuracy of data produced by Statistics Canada, Health Canada, and the Canadian Institute for Health Information for inclusion in the federal, provincial, and territorial health indicators reports released in September 2002. Finally, the audit reviewed the Health Information Roadmap Initiative and Health Information Contribution Program to ensure that the requirements of the agreements were met.

In carrying out this work, we interviewed managers responsible for health statistics at Statistics Canada. We also reviewed Agency publications, reports, and internal documents. As well, we reviewed work at Health Canada related to health indicators.

Members of the audit team participated in work led by the Office of the Auditor General of British Columbia to examine the quality assurance systems and practices in place for the Canadian Institute for Health Information's Hospital Morbidity Database and Discharge Abstract Database, from which the former is derived. This work was undertaken because Statistics Canada uses the Hospital Morbidity Database, and several health indicators rely on it as a source of data.

Criteria

We expected the following:

- Statistics Canada would have quality assurance systems and practices that are applied across its statistical programs.
- The adequacy of quality assurance systems and practices in individual statistical programs and products would be assessed systematically. This includes a determination of the quality of data received from other organizations.
- The results of quality assurance systems and practices would be used in managing quality and in reporting performance.
- The Agency would have an effective policy on informing users about data quality and methodology to help ensure informed use of its statistical products.
- Individual statistical programs would appropriately inform users about data quality and methodology when data are disseminated.

- In producing data for health indicators reports, the quality of data received from other organizations would be determined, data elements would be accurately extracted from the data source, definitions and formulae would be correctly applied, calculations and presentations would be free of errors, and quality limitations would be adequately disclosed.
- The Health Information Roadmap Initiative grant would be monitored by signatories according to responsibilities outlined in agreements, including determining whether work has been undertaken as outlined in the agreements.

Audit team

Assistant Auditor General: Maria Barrados
Principal: Barry Leighton
Director: Glenn Wheeler

Yves Genest
Denis Jobin
Catherine Livingstone
John McGrath
Albert Melanson
Paul Pilon

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Appendix Jurisdictions' verification of health indicators reports

The governments of Canada, the territories and the provinces have adopted different approaches to meet the September 2000 First Ministers Meeting Communiqué on Health requirement in respect of "third party verification" for their health reports. Some have engaged their auditor to provide audit assurance on their health reports. Others have asked for specified auditing procedures to be applied. The paragraphs below outline the major differences between an audit assurance engagement and a specified auditing procedures engagement. For a complete comparison, please refer to the Canadian Institute of Chartered Accountants Handbook section 5025 for audit assurance engagements and section 9100 for specified auditing procedure engagements. For the reasons described in the following paragraphs, an audit under CICA Handbook section 5025 is the advisable approach.

In an audit assurance engagement, the auditor's responsibility is to offer assurance to users, in the form of an audit opinion, on a report prepared by management. The auditor determines the nature, extent, timing, appropriateness, and sufficiency of audit procedures which, in the auditor's judgment, are necessary to provide a high level of assurance concerning the subject matter or the performance indicators in the health care report in the present context.

In a specified auditing procedure engagement, the auditor's responsibility is to report the results of applying auditing procedures specified by management. As the extent of specified auditing procedures may vary from engagement to engagement, such engagements are difficult to compare. And since the extent of the procedures performed is not sufficient to constitute an audit, the reports do not provide an audit opinion. Reports state those procedures actually applied and only the factual results of those procedures, leaving the reader to determine whether, in the present context, the performance indicators are complete, sufficiently accurate for intended users, and adequately disclosed in accordance with the stated criteria.

The following is a list of jurisdictions that have engaged their auditor to provide audit assurance on their health reports and those that have asked for specified auditing procedures to be applied.

Audit Assurance CICA 5025	Specified Auditing Procedures CICA 9100
British Columbia	Alberta
Saskatchewan	Ontario
Manitoba	New Brunswick
Quebec	Prince Edward Island
Nova Scotia	Newfoundland and Labrador
Canada Nunavut Yukon Northwest Territories	

Source: Canadian Council of Legislative Auditors – Health Information Study Group

Report of the Auditor General of Canada to the House of Commons—December 2002

Main Table of Contents

Matters of Special Importance—2002
Foreword and Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada—Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada—Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

Appendices

2002

Report of the
Auditor General of Canada
to the House of Commons

DECEMBER

Chapter 7
Canadian Space Agency—
Implementing the Canadian Space Program

Office of the Auditor General of Canada

The December 2002 Report of the Auditor General of Canada comprises 11 chapters, Matters of Special Importance—2002, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

Ce document est également disponible en français

© Minister of Public Works and Government Services Canada 2002
Cat. No. FA1-2002/2-15E
ISBN 0-662-33113-3

Chapter

7

Canadian Space Agency

Implementing the Canadian Space Program

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

Table of Contents

Main Points 1

Introduction 3

The Canadian Space Program 3
Focus of the audit 5

Observations and Recommendations 6

Strategic planning 6
A new strategy is needed to resolve an imbalance between obligations and funding 6
A legacy of funding obligations hampers the Agency's flexibility for new initiatives 7
The Agency needs to reassess its capacity to deliver its work program 7
The Space Program Management Framework is still not operating as intended 9

Project management 11
Managing projects is at the core of the Agency's business 11
Delays, cost overruns, and decisions by international partners in major Crown projects prove costly to the Agency 11
The Project Approval and Management Framework is not fully implemented 14

Human resources management 15
There is an urgent need to develop a strategic plan for human resources 15
The Agency has neither a demographic profile of its workforce nor a comprehensive human resources plan 16
A substantial workforce increase is under way despite the absence of a strategic plan 17

Performance measurement 19
The performance measurement process requires improvement 19
Reporting of performance is incomplete and not linked to strategic outcomes 19

Conclusion 22

About the Audit 23

Appendices

A. Canadian Space Station program—A brief history 25
B. RADARSAT program—A brief history 26

Canadian Space Agency
Implementing the Canadian Space Program

Main Points

7.1 The Canadian Space Agency needs to develop a new strategic plan that can help it balance the activities required of it under the Canadian Space Program and its annual funding level. Currently, it is unable to meet the expectations for the Space Program fully because of financial obligations that the government incurred in the past and that extend into the future; to some extent the Agency's own process of setting priorities is also responsible. The current imbalance between activities required under the Canadian Space Program and the Agency's financial capacity is likely to worsen in the next five years.

7.2 The Agency has only partially assessed the shortfall in its capacity to deliver the Canadian Space Program, and it needs to inform the government of the gaps in its ability to meet the Program's objectives.

Background and other observations

7.3 The Space Program Management Framework is lacking some key elements that are required under the Canadian Space Program, including stakeholder participation in setting priorities, strategies, and plans for the Agency's five key service lines. As a result, the Agency is making strategic decisions that affect the funding of the service lines without the benefit of input from the advisory structure approved by the government, although it has held informal consultations with key stakeholders.

7.4 The Agency's project and risk management practices are generally sound in projects over which it has prime responsibility and control. However, in two major Crown projects it has been unable to escape the negative effects of program slippage, cost escalation, and unilateral decisions by international partners. For example, the three-year delay of the launch of Canada's third component for the International Space Station (ISS) will cost the Agency about $13 million to maintain that component's full operational capability; and the withdrawal of the National Aeronautics and Space Administration (NASA) from the launch arrangement resulted in a delay of more than two years and additional costs of $167 million for the Agency's RADARSAT-2 project. In addition, a projected cost overrun of US$5 billion in the ISS program by NASA caused the United States Congress to impose a temporary budget cap of US$25 billion while NASA corrects its program management practices. If this cap is maintained, it threatens to severely limit Canada's ability to conduct the research for which it has invested in the program.

7.5 The Agency enjoys a strong reputation for excellence. Although it is not a large organization, its programs are highly visible nationally and internationally. They are a source of national pride for most Canadians and have earned Canada worldwide recognition in the space industry.

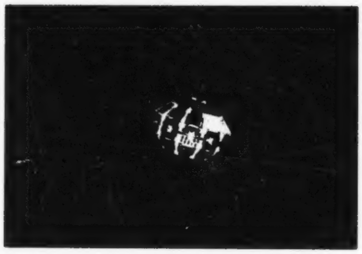
7.6 There is an urgent need for the Agency to develop a strategic human resources plan. Although senior managers are aware of their short-term needs, a human resources committee has yet to be established and made responsible for developing a comprehensive human resources plan that links the needs of directorates to operational plans and strategic objectives. The Agency is currently increasing its indeterminate workforce significantly while reducing its reliance on term employees and contract workers. However, it has not aligned its present competencies with the projects it has planned for the short and the long terms to identify clearly the additional resources it needs.

7.7 The Agency does not have all the necessary processes to report on its performance. It has developed few performance indicators by which to measure its progress toward desired strategic outcomes. Currently, in reporting to Parliament, the Agency arbitrarily matches the strategic outcomes with consolidated information from the reports of its directorates.

The Agency has responded. The Canadian Space Agency has generally agreed with our recommendations. Actions it has under way or planned are set out in its response to each recommendation in the chapter.

Introduction

The Canadian Space Program



Alouette 1 research satellite, launched 29 September 1962 to study the ionosphere. Canada was the third country in the world, after Russia and the United States, to design and build its own satellite.

7.8 Canada has had a space program since Canadians first studied the upper atmosphere with the assistance of balloons and rockets, followed by the launch of the Alouette 1 satellite in 1962. Early activities were scattered among several government departments and agencies and co-ordinated by the Interdepartmental Committee on Space. However, the Committee was not in a position to set priorities and reallocate funds among those departments and agencies. The space program remained fragmented, the government's support for the Canadian industry was inconsistent, and the management structure was confusing to Canada's international partners.

7.9 Several studies over the years concluded that a distinct Canadian space agency was needed to focus Canada's space efforts. A separate agency that emphasized the contracting out of research and development could ensure the active involvement of the private sector and universities and augment the social and economic benefits of Canada's space program.

7.10 The Canadian Space Agency was established by order-in-council in March 1989. Several activities and programs were transferred to the new Agency from what were then the Department of Energy, Mines and Resources, the Department of Communications, and the Ministry of State for Science and Technology. However, a number of space-related activities remained in other departments and agencies, and they continue there today. The two largest programs transferred to the Agency governed Canada's participation in the International Space Station and the RADARSAT remote-sensing satellite.

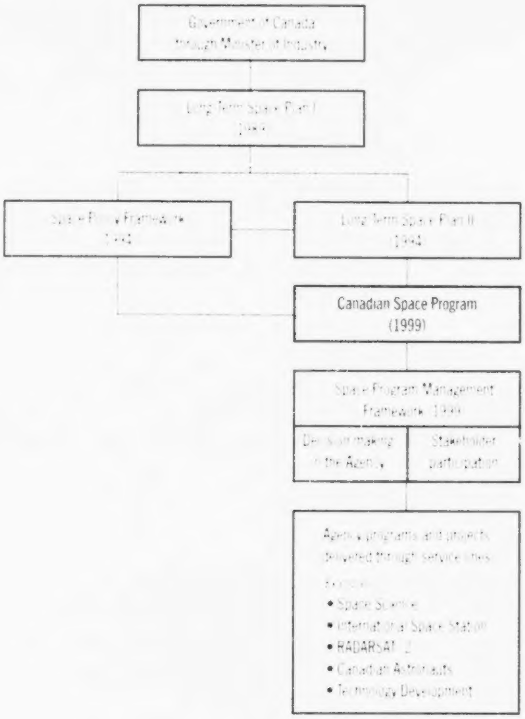
7.11 In 1999, responding to the changing international space sector and the increasing demand for space technologies, the government announced the new Canadian Space Program to be managed by the Agency. Exhibit 7.1 shows the main elements of the Program, whose main objectives are

- to develop and apply space science and technology to meet Canadian needs, and
- to develop an internationally competitive space industry.

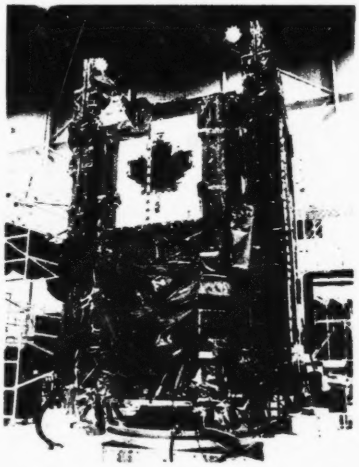
7.12 The Canadian Space Program is guided by the 1994 Space Policy Framework. The Framework states that space is strategically important in Canada's transition to a knowledge-based economy and to the social, scientific, sovereignty, security, and foreign policy objectives of the federal government. Under the Framework, the Agency co-ordinates the federal government's efforts in civil space-related research, science and technology, industrial development, and international co-operation.

7.13 The Space Program Management Framework describes the Agency's decision-making structure and the means by which various stakeholder committees participate in defining, implementing, and developing the Canadian Space Program.

Exhibit 7.1 Structure of the Canadian Space Program


Government of Canada through Minister of Industry
Long Term Space Plan I (1986)
Space Policy Framework (1994)
Long Term Space Plan II (1994)
Canadian Space Program (1999)
Space Program Management Framework (1999)
Decision making in the Agency
Stakeholder participation
Agency's programs and projects delivered through service lines
Example:
• Space Science
• International Space Station
• RADARSAT–2
• Canadian Astronauts
• Technology Development

7.14 To deliver the Program, the Agency has organized its activities under a single business line—Space Knowledge, Applications and Industry Development—with seven service lines (Exhibit 7.2).



RADARSAT–1 at the Agency's David Florida Laboratory in Ottawa during testing and assembly.

7.15 The Canadian Space Program is heavily oriented toward domestic and international partnerships and close collaboration with key federal, provincial, and academic stakeholders (Exhibit 7.3).

7.16 The Agency's mandate under the *Canadian Space Agency Act* is to

- promote the peaceful use and development of space,
- advance the knowledge of space through science, and
- ensure that space science and technology provide social and economic benefits for Canadians.

7.17 The Agency reports to Parliament through the Minister of Industry. In March 2002, the Agency employed about 500 people and had some 400 contract workers. Most of its staff work at the head office, the John H. Chapman Space Centre in Saint-Hubert, Quebec. Some staff and the spacecraft testing facility are in Ottawa, and a small number work in Washington, D.C.; Houston, Texas; and Paris, France.

Exhibit 7.2 Canadian Space Agency's service lines

Key service lines assigned priority under the Canadian Space Program

- **Space Science**—Advancing scientific knowledge in areas of strategic importance to Canada by giving Canadian scientists access to the unique environment of space (for example, space life science, microgravity science, space astronomy, and space exploration).
- **Earth and Environment**—Using space technologies to understand, monitor, and protect the Earth and its environment (for example, RADARSAT-1 and RADARSAT-2).
- **Human Presence in Space**—Providing a meaningful and visible contribution to international efforts to establish a human presence in and beyond low Earth orbit, and ensuring that this contribution will bring tangible benefits to Canada (examples are the Canadian Astronaut Program and Canada's contribution to the International Space Station).
- **Satellite Communications**—Ensuring that all Canadians have access to new communications technologies and services and positioning Canadian industry to participate significantly in the new global communications business.
- **Generic Space Technologies**—Developing innovative and emerging technologies to ensure the growth and competitiveness of the Canadian space industry to meet future needs of the Canadian Space Program and maximize commercialization of space technologies in both space and non-space applications.

Other service lines

- **Space Qualification Services**—Providing an environmental test facility capable of meeting the current and emerging needs of Canada's space community and space-related objectives (the David Florida Laboratory).
- **Comptrollership and Awareness**—Ensuring that the Agency performs its role as the national leader of the Canadian Space Program.

Source: Canadian Space Agency

7.18 Until 1999 the Agency lacked stable ongoing funding; it was funded under long-term space plans approved by Cabinet and consisting mainly of major Crown projects. The Agency had to seek Cabinet approval for any supplementary funding required for projects. The 1999 federal Budget provided $430 million in additional funding over the three years that followed and, beginning in 2002–03, a stable envelope of $300 million to deliver the Canadian Space Program.

Focus of the audit

7.19 This was our first value-for-money audit of the Canadian Space Agency. Our objective was to assess whether the Agency is implementing the Canadian Space Program with due regard to economy, efficiency, and effectiveness. We looked at how the Agency selects programs or projects for funding and how it monitors and evaluates those it funds. We looked at how the Agency ensures that it has the staff it needs at the right time. Finally, we assessed how it reports on its performance.

7.20 More information on our audit objectives, scope, approach, and criteria can be found at the end of the chapter in About the Audit.

Exhibit 7.2 Canadian Space Agency's service lines

Key service lines assigned priority under the Canadian Space Program

- **Space Science** Advancing scientific knowledge [illegible] Canada by giving Canadian scientists access to [illegible] (for example, space life sciences, microgravity, [illegible] exploration).

- **Earth and Environment** Using space technologies to understand [illegible] protect the Earth and its environment (for example, RADARSAT [illegible]).

- **Human Presence in Space** Providing [illegible] international efforts to establish [illegible] and ensuring that this contribution [illegible] the Canadian Astronaut Program and Canada's [illegible] Space Station).

- **Satellite Communications** Ensuring that all Canadians [illegible] communications technologies and services and positioning Canada [illegible] participate significantly in the new global [illegible].

- **Generic Space Technologies** Developing innovative [illegible] ensure the growth and competitiveness of the Canadian space industry [illegible] future needs of the Canadian Space Program and [illegible] space technologies to both space and non-space applications.

Other service lines

- **Space Qualification Services** Providing an environmental test facility [illegible] meeting the current and emerging needs of Canada's space community, and [illegible] to meet objectives (the David Florida Laboratory).

- **Comptrollership and Awareness** Ensuring that the Agency performs [illegible] awareness of the Canadian Space Program.

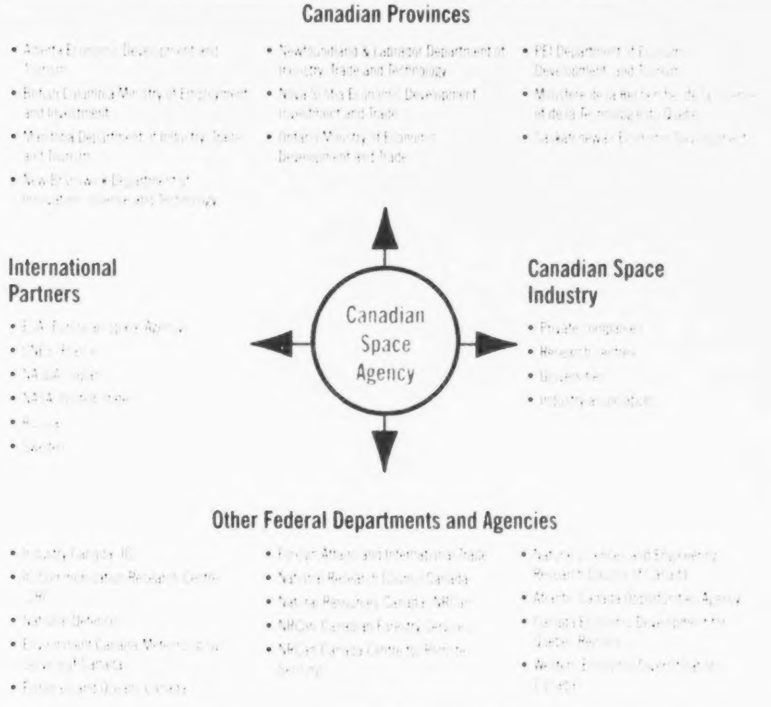
7.18 [illegible]

Focus of the audit

7.19 [illegible] Agency [illegible] assessed how it reports on its performance.

7.20 More information on our audit objectives, scope, approach and criteria can be found at the end of the chapter in About the Audit.

Exhibit 7.1 The Canadian Space Agency's main partners and stakeholders



Canadian Provinces

- Alberta Economic Development and Tourism
- British Columbia Ministry of Employment and Investment
- Manitoba Department of Industry, Trade and Tourism
- New Brunswick Department of Innovation, Science and Technology
- Newfoundland & Labrador Department of Industry, Trade and Technology
- Nova Scotia Economic Development, Investment and Trade
- Ontario Ministry of Economic Development and Trade
- PEI Department of Economic Development and Tourism
- Ministère de la Recherche, de la Science et de la Technologie du Québec
- Saskatchewan Economic Development

International Partners

- ESA (European Space Agency)
- CNES (France)
- NASDA (Japan)
- NASA (United States)
- Russia
- Sweden

Canadian Space Industry

- Private companies
- Research centres
- Universities
- Industry associations

Other Federal Departments and Agencies

- Industry Canada (IC)
- IC Communications Research Centre (CRC)
- National Defence
- Environment Canada Meteorological Service of Canada
- Fisheries and Oceans Canada
- Foreign Affairs and International Trade
- National Research Council Canada
- Natural Resources Canada (NRCan)
- NRCan Canadian Forestry Service
- NRCan Canada Centre for Remote Sensing
- Natural Sciences and Engineering Research Council of Canada
- Atlantic Canada Opportunities Agency
- Canada Economic Development for Quebec Regions
- Western Economic Diversification Canada

Observations and Recommendations

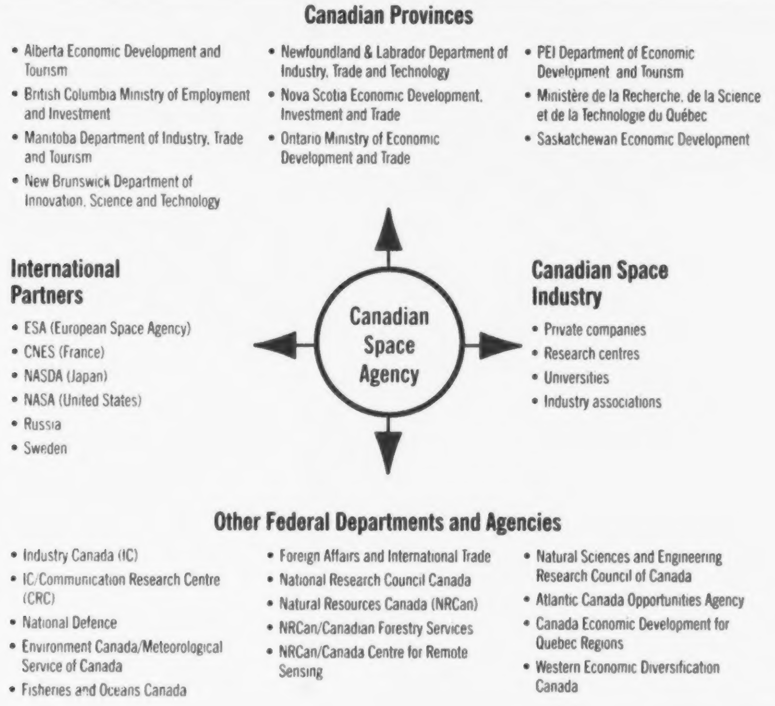
A new strategy is needed to resolve an imbalance between obligations and funding

7.21 [illegible]

7.22 [illegible]

7.23 [illegible]

Exhibit 7.3 The Canadian Space Agency's main partners and stakeholders



Canadian Provinces

- Alberta Economic Development and Tourism
- British Columbia Ministry of Employment and Investment
- Manitoba Department of Industry, Trade and Tourism
- New Brunswick Department of Innovation, Science and Technology
- Newfoundland & Labrador Department of Industry, Trade and Technology
- Nova Scotia Economic Development, Investment and Trade
- Ontario Ministry of Economic Development and Trade
- PEI Department of Economic Development and Tourism
- Ministère de la Recherche, de la Science et de la Technologie du Québec
- Saskatchewan Economic Development

International Partners

- ESA (European Space Agency)
- CNES (France)
- NASDA (Japan)
- NASA (United States)
- Russia
- Sweden

Canadian Space Agency

Canadian Space Industry

- Private companies
- Research centres
- Universities
- Industry associations

Other Federal Departments and Agencies

- Industry Canada (IC)
- IC/Communication Research Centre (CRC)
- National Defence
- Environment Canada/Meteorological Service of Canada
- Fisheries and Oceans Canada
- Foreign Affairs and International Trade
- National Research Council Canada
- Natural Resources Canada (NRCan)
- NRCan/Canadian Forestry Services
- NRCan/Canada Centre for Remote Sensing
- Natural Sciences and Engineering Research Council of Canada
- Atlantic Canada Opportunities Agency
- Canada Economic Development for Quebec Regions
- Western Economic Diversification Canada

Source: Canadian Space Agency

Observations and Recommendations

[illegible]

A new strategy is needed to resolve an imbalance between obligations and funding

7.21 The Canadian Space Agency is an organization in transition. For most of the 1990s, its programs and projects needed Cabinet's explicit approval and were largely major Crown projects under a Long-Term Space Plan. The Agency's priorities were clear, and it had a small number of very large projects to manage; its strategic and operational management practices reflected that environment.

7.22 The new Canadian Space Program in 1999 and the approval of stable ongoing funding for the Agency meant that it would need to make some fundamental changes in the way it operated. It now had to decide its own priorities and manage them within its $300 million annual budget. It also had to change its approach to human resources management—from an extensive use of term employees and contract workers on each new project to a greater use of indeterminate employees to meet long-term needs.

7.23 The Agency receives many requests for funding. New initiatives reflect the evolving nature of the space business in Canada and internationally. Past decisions to fund major Crown projects represent ongoing and long-term financial commitments. With a fixed budget, the Agency must make critical choices: Where, why, and how will it intervene with the maximum impact?

7.24 We expected that to fulfil its mandate and obligations under the Canadian Space Program, the Agency would have clear objectives and strategies that would take into account its capacity, the demands of its operating environment, and the needs and priorities of its stakeholders. The Program also requires that in defining its future strategic direction the Agency consult closely with science-based federal departments, provincial governments, academia, and the space industry.

A legacy of funding obligations hampers the Agency's flexibility for new initiatives

7.25 The government decided in 1975 to launch its program of remote sensing radars, and in 1984 to participate in the International Space Station (ISS) program. Both decisions were made before the Canadian Space Agency was created. However, both of these major Crown projects are now and will continue to be the Agency's responsibility for the next decade or longer.

7.26 The risks associated with these two major commitments, each involving international partners, have caused delays and significant cost increases for the Agency. For example, the launch of Canada's third component for the International Space Station was delayed for three years, adding about $13 million to the Agency's costs. Furthermore, NASA's withdrawal from the launch arrangement resulted in a launch delay of more than two years and additional costs of $167 million for the Agency's RADARSAT-2 program. And NASA's projected cost overrun of US$5 billion on the International Space Station has resulted in a temporary budget cap of US$25 billion, imposed on the program by the U.S. Congress while NASA corrects its program management practices. If maintained, this cap will reduce the science capacity of the space station and could limit Canada's ability to conduct the research for which it has already invested in the program.

7.27 The current and future financial obligations imposed by these two major Crown projects seriously limit the Agency's flexibility to fund new program initiatives and pursue the full range of scientific developments currently envisaged under the Canadian Space Program. They have meant the cancellation or postponement of approved activities. They also limit the Agency's ability to provide new opportunities to Canada's research and development community, to maintain a position of excellence worldwide in the exploration and use of space, and to optimize the benefits of participating in international space activities. Overall, they have created an imbalance between the Agency's obligations and its financial capacity, a situation that is likely to worsen in the next five years.

The Agency needs to reassess its capacity to deliver its work program

7.28 Prior commitments, cost overruns in some projects, and the desire to fund some emerging new initiatives left the Agency facing a funding shortfall for fiscal year 2002–03, which it estimated at about $58 million. To address the situation, the Agency completed a priority review exercise in early 2002 to determine which planned programs and projects it would fund for the current year. This exercise, the first in an annual process, consisted of a review and ranking of all the Agency's programs and projects and a number of proposals not yet funded. The criteria used to rank programs and projects were defined broadly and in line with the Agency's strategic outcomes (set out in paragraph 7.89). The review resulted in the elimination of the $58 million shortfall and the reallocation of about $12.5 million to fund new initiatives for the current fiscal year.

7.29 However, a corporate-wide ranking of programs by merit is difficult because senior managers lack detailed knowledge of programs outside their own core function directorates. Furthermore, we are concerned about the short-term focus of the priority review exercise. While the Agency has addressed the funding shortfall for the current fiscal year, we are concerned that it has analyzed neither the future financial implications of some current proposals nor the prospects for their continued funding.

7.30 **Some current proposals and emerging initiatives.** Canada has had co-operation agreements with the European Space Agency (ESA) since 1979 and is the only country outside Europe that participates in the ESA's programs. In the past, Canada's annual contributions to ESA programs have ranged from $20 million to $30 million; its contribution for 2001–02 amounted to $21.8 million. The ESA's industrial policy guarantees member states a financial return on their contributions as well as technology development contracts. Its contracts with the Canadian space industry reflect the size of the Canadian Space Agency's contribution—mainly to Earth observation and satellite communications.

7.31 As part of its priority review exercise, the Agency assessed the benefits of continuing the Canada-ESA co-operation. It concluded that Canada's agreement with the European Space Agency is a valuable strategic framework for international space co-operation, and it decided to support continued co-operation, including a few new ESA programs.

7.32 The Agency hopes to participate in the development and validation phase of the Galileo project, Europe's global navigation satellite system that is expected to complement the U.S. Global Positioning System but with enhanced technology. If the ESA accepts its bid to participate, the Agency will have to make a five-year commitment of funds and persuade other federal government departments to make unanticipated contributions in order to make Canada's contribution meaningful.

7.33 In our opinion, the new Agency initiatives in ESA programs represent only a preliminary involvement by Canada, while its future participation in the programs is far from certain given the Agency's budget limitations. We believe this shows the importance of better integrating its planning system with its strategic direction before the Agency contemplates any significant new investments.

7.34 The Agency has made a commitment to preserve its in-house expertise in space technologies, satellite operations, program management, life-cycle support of the ISS, and hardware testing. The President of the Agency has stated his desire that the Agency also maintain a minimum research and development capacity. In addition, the Agency currently faces other challenges that include increasing its indeterminate workforce, adjusting to changes such as the government's modern comptrollership initiative, and funding other new initiatives.

7.35 The Agency recently decided to participate in the international Mars Exploration program led by the United States. Ongoing participation in this program is conditional on the Agency's obtaining the required funding. This is a long-term program that requires a high level of funding. It is clear that while the Agency is motivated to pursue leading-edge space programs and projects that could benefit Canada and the Canadian space industry, it must make choices among competing proposals to remain within its budget.

7.36 **Recommendation.** The Canadian Space Agency should develop a new strategic plan with clear objectives and strategies that reflect its current and long-term funding obligations and proposed new initiatives and that take account of its financial capacity. The Agency should then advise the government of any significant gaps in its ability to deliver its obligations under the Canadian Space Program and the consequences of not being able to undertake specific initiatives.

Agency's response. This action is currently under way. In the past, the Canadian Space Agency has developed several strategic plans, which were submitted for approval to the government. The Agency will take into account the points raised by the Auditor General in the development of a new strategic plan to be completed during 2003. The Agency will continue to advise the government on its ability to deliver its obligations under the Canadian Space Program.

The Space Program Management Framework is still not operating as intended

7.37 The Space Program Management Framework of 1999 formalizes the structure and processes by which the Agency conducts its business and interacts with its stakeholders. One of the Framework's guiding principles is that stakeholders must have visible input into resource allocation decisions for the Canadian Space Program. We expected that the key components of the Framework would be in place and roles and responsibilities well understood by stakeholders and by Agency staff.

7.38 The Framework calls for the creation of the Canadian Space Agency Advisory Council and service line advisory groups. The Advisory Council is to advise the President on corporate strategic direction; the service line advisory groups are to advise the Agency on priorities, strategies, and plans for each of the five key service lines. The service line priorities and strategies together are to represent the core of the Agency's strategic plan.

7.39 The Advisory Council was not formed until late 2001, due in part to senior management changes at Industry Canada and at the Agency. On the Agency's recommendation the Minister of Industry appointed the members of the Advisory Council, who include representatives of the Government of

Canada, industry, academia, and other groups. The Council has yet to fulfil its central role of advising the Agency on priorities during the strategic planning process, as approved by the government in 1999. For example, it had no input into preparing the Agency's 2002–03 *Report on Plans and Priorities*; it was able to review the document only after it had been finalized and submitted.

7.40 A corporate Strategic Development Directorate was created in 1999 to separate strategic planning from program management. Programs are managed by senior managers in each core function directorate, while a separate group of senior managers, the service line co-ordinators, are to co-ordinate program development. However, the Strategic Development Directorate has not been fully active, partly due to staffing delays.

7.41 At the time of our audit, the Earth and Environment Service Line Advisory Group was the only one formed. Management has since advised us that due to delays in staffing the service line co-ordinator positions, the Agency only recently established advisory groups for the Human Presence in Space and the Space Science service lines. Advisory groups for the Generic Space Technologies and the Satellite Communications service lines are expected to be formed before the end of 2002.

7.42 At the time of our audit, the Agency was preparing a revised Government of Canada Strategy on Space to present to Cabinet in the fall of 2002. This document was expected to form part of service line strategies targeted for December 2002 and an agency-wide strategic plan targeted for June 2003.

7.43 We believe the Agency should have an effective planning function by now and should be consulting with stakeholders on revising the long-term strategic plan. In our opinion, the Agency does not yet have the key components of the Space Program Management Framework. Some components are operating but are not fully integrated within the Framework. As a result, the Agency is making important decisions that affect funding to the service lines without the benefit of input from the advisory structure approved by the government, although informal consultations have been held with key stakeholders.

7.44 **Recommendation.** The Agency should ensure that all remaining components of the Space Program Management Framework are put in place as soon as possible.

Agency's response. This action is under way. The Agency agrees with the recommendation and will ensure that all components of the Space Program Management Framework are in place before the end of 2002.

7.45 **Recommendation.** The Agency should continue to consult with all key stakeholders in its formulation of long-term strategies for the Canadian Space Program and should ensure that the strategic advice of the Advisory Council is considered in the Government of Canada Strategy on Space.

Agency's response. The Agency values the input of its stakeholders and will continue to consult its key stakeholders in the formulation of long-term strategies for the Canadian Space Program, including the Government of Canada Strategy on Space.

Project management

Managing projects is at the core of the Agency's business

7.46 Contracts for projects involving industry, universities, and specialized research institutes represent about 75 percent to 80 percent of the Agency's budget; project management, internal research and development, and support functions account for the rest. In early 2002, the Agency's priority review exercise included 134 programs or projects and 20 additional proposals not yet funded.

7.47 We reviewed the Agency's project management practices in two major Crown projects—the Canadian Space Station program and the RADARSAT program—and in seven other capital projects under its full responsibility and control. We expected that the Agency would monitor, evaluate, and report to decision-makers both the costs, potential risks, and benefits associated with the two major projects and their impact on programs of other service lines. We also looked for generally accepted principles of project management in projects contracted to Canadian industry and projects carried out with international partners. Our audit did not examine the Agency's contracting practices or compliance with government contracting regulations.

7.48 We found that although generally sound, the Agency's project management and risk management practices are applied inconsistently in projects over which it has prime responsibility and control. Project documentation, cost projections, and risk assessments do not always meet the criteria set out in the Agency's Project Approval and Management Framework.

7.49 In consultation with the Treasury Board Secretariat, the Agency established its Risk Assessment and Commitment Control Plan, a five-year plan to ensure that resources are set aside to mitigate risks to approved programs. In some cases, this means that some planned programs are put on hold until identified risks to approved programs have been removed. However, managers are often reluctant to assign risk levels that could push the costs of proposed projects above approval thresholds. Further, in programs involving international partners the risks are difficult to anticipate.

Delays, cost overruns, and decisions by international partners in major Crown projects prove costly to the Agency

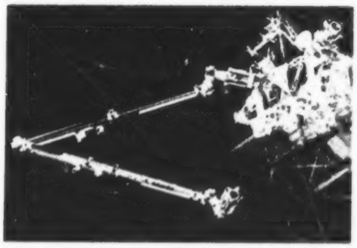
7.50 We found that the Agency has followed generally accepted project management principles in the Canadian Space Station and RADARSAT-1 programs. In its two major Crown projects with international partners, however, it has been unable to escape the negative effects of program slippage and cost escalation. Project delays, cost overruns, and decisions by its international partners have increased the costs of Canada's contributions to the International Space Station program, could reduce the opportunities for Canadian astronauts to participate, and could delay scientific experiments.

Furthermore, NASA's decision not to launch the RADARSAT-2 satellite for Canada has added considerably to the Agency's costs. We are concerned that Canada's agreements with the Agency's international partners involve a level of moral commitment that could lead to significant downstream costs and limit the Agency's budget flexibility.

The Mobile Servicing System—This includes the Space Station Remote Manipulator System, the Mobile Base System, and the Special Purpose Dexterous Manipulator, their related ground equipment and operations, and support facilities located on the space station and on the ground.

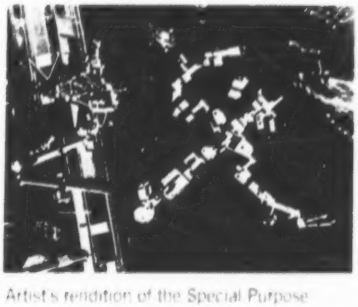
7.51 **The Canadian Space Station program.** Appendix A provides a brief history of the Canadian Space Station program, Canada's participation in the International Space Station (ISS). Canada's main contribution to the ISS is the $1.4 billion Mobile Servicing System; that amount includes the cost of a major Crown project to construct the Mobile Servicing System and the cost of operating it for the life of the space station.

7.52 Canada is a partner in the management, operation, and use of the ISS over its entire lifetime. Until 2015–16 Canada is also responsible for the costs of the Mobile Servicing System's ongoing operational support, logistics and sustaining engineering, repair and overhaul, astronaut training, and the related ground facilities (estimated at $45 million a year). When Canada increased its contribution to the space station to include the Special Purpose Dexterous Manipulator (SPDM) and Canadarm2 support, NASA agreed that Canada could have a specified use of the space station without paying its annual share of the common system operating costs. Around 2008, Canada will start paying a 2.3 percent share of the common system operating costs (a share currently estimated at $50 million a year and likely to increase). Other financial obligations associated with this program have not yet been estimated. These include the costs of development, launch, and retrieval of payloads as well as the future decommissioning costs. Having signed a cross-waiver of liability with the international partners, Canada is also exposed to the cost of repairing or replacing the Mobile Servicing System if it is damaged on orbit and the cost of replacing the Special Purpose Dexterous Manipulator if it is lost due to a launch failure.



Space Station Remote Manipulator System (Canadarm2) and Mobile Base System, two of the three components of the Mobile Servicing System, Canada's contribution to the International Space Station.

7.53 In 2002, NASA projected a cost overrun on the program of US$5 billion, which led the U.S. Congress to impose a temporary budget cap of US$25 billion. That decision has a major impact on Canada's future use of the ISS, since it could delay indefinitely the completion of three of the planned components and could reduce the capacity of the ISS from seven astronauts to three. Since the time of 2.5 astronauts will be taken up in operating and maintaining the space station, there would be little opportunity to carry out the science for which it is being constructed.

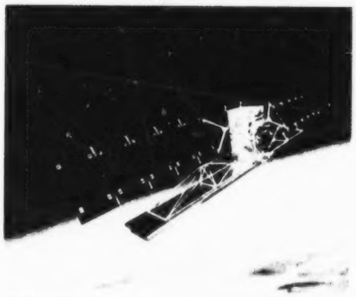


Artist's rendition of the Special Purpose Dexterous Manipulator (SPDM) attached to the Canadarm2 of the Mobile Servicing System.

7.54 Another consequence of the temporary budget cap and the resulting redesign of the ISS is a delay in the launch of Canada's third and final component for the space station, the Special Purpose Dexterous Manipulator (SPDM). The launch was originally scheduled for 2002 but has now been delayed until 2005. The contractor is scheduled to deliver the SPDM in 2002. It will cost about $13 million to keep it in operating condition during its storage period.

7.55 We are concerned about a July 2002 report of the U.S. General Accounting Office, which noted that NASA's financial management system had proved inadequate for tracking ISS costs; new studies were to include a reassessment of long-term operating costs. Since 2.3 percent of those costs will eventually be Canada's responsibility, the reassessment could increase the costs to the Agency and cause an additional drain on the resources it has available for other projects.

7.56 In our opinion, the key risks associated with Canada's involvement in the NASA-led ISS program could prove to be beyond the Agency's ability to manage. A major objective of the International Space Station was to serve as a platform for scientific experiments. However, it will be only partially available for scientific use by Canada until NASA's cost control problems are resolved and the crew increases beyond three, which is not expected before 2008. If the crew size is not increased, there is also a risk that the space station may never be available for its intended purpose. Furthermore, the costs of the long-term maintenance and operations of the ISS and the Mobile Servicing System will eventually absorb about a third of the Agency's current annual budget of $300 million.



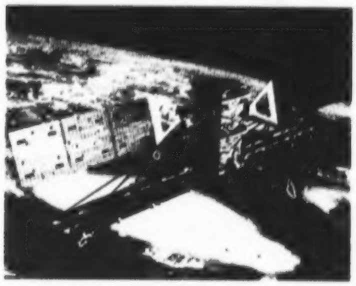
RADARSAT-1 Earth observation satellite, launched in November 1995, uses a powerful microwave Synthetic Aperture Radar (SAR) system to collect imagery of the Earth day or night and in all weather conditions.

7.57 **The RADARSAT program.** Appendix B provides a brief history of the RADARSAT Program. RADARSAT-1 is a $678 million Canadian-led project involving the private sector, nine provinces, and the United States. The federal government was responsible for developing the satellite, and it continues to manage its operations; the private sector is responsible for marketing, data processing, and data distribution. NASA provided the satellite launch in return for access to the data.

7.58 The RADARSAT-2 project followed, to maintain the continuity of data from RADARSAT-1 and move toward privatization; the government's long-term objective is to create a commercial satellite remote sensing business in Canada. The operations phase of RADARSAT-2 is expected to last seven years. A prime contractor was selected through a competitive process in 1998 to construct and operate this satellite.

7.59 A decision by NASA, however, had serious consequences for the costs of RADARSAT-2. In May 1994, the Canadian Space Agency and NASA signed "Arrangements for Enhanced Cooperation in Space" to provide for the launch of RADARSAT-2 "involving essentially the same terms as RADARSAT-1." In December 1998, NASA informed the Agency that it would not conclude a formal agreement as envisaged in the 1994 arrangement. There are conflicting explanations for this change in NASA's position.

7.60 That decision resulted in a launch delay of more than two years and additional project costs of about $178 million. The Agency's share of the additional cost was $167 million, with the balance borne by the prime contractor. To cover the cost increase, the Agency reallocated $167 million from its budget over the four years starting at 2001–02. This has had a significant impact on the Agency's ability to implement some of the new application development programs under the Canadian Space Program.



The launch of RADARSAT-2 satellite was delayed more than two years to 2004, resulting in additional project costs of about $178 million.

7.61 Major Crown projects such as the International Space Station and the RADARSAT program, often referred to as Big Science, involve a level of risk and complexity that presents special challenges for those asked to approve them. In our opinion, Big Science proposals submitted for Cabinet approval need to be as complete and as accurate as possible, with information for decision makers on the following:

- The unique scientific nature of the project that can push the boundaries of knowledge.
- The many uncertainties and risks associated with the project and a thorough assessment of whether they are internal (technological or scientific) or external (inflation, partners' withdrawal).
- The costs of all project cycles — from construction to implementation, ongoing operation and maintenance, research and development, and decommissioning.
- The financial involvement of all federal organizations and an indication of whether the funding needs government approval.
- The expected scientific benefits based on adequate analysis, including valid peer review.
- The expected economic benefits based on adequate analysis, recognizing that commercial potential may be modest.
- Procedures for evaluating a project's results and benefits using measures that reflect an appropriate mix of outcomes and perspectives (for example, scientific accomplishments and economic benefits).

7.62 **Recommendation.** In proposing future projects for Cabinet's approval, the Agency should consider carefully its ability to sustain funding commitments for projects that involve high risk, international partners, and leading-edge technology, and should fully disclose to decision makers all known and potential risks and costs.

Agency's response. The Agency agrees with the recommendation and will continue to identify and disclose potential risks and costs. It should be noted, however, that the Canadian Space Agency leverages international partnerships to extend the reach of many of its projects, and thus cannot fully control all programming issues associated with these projects.

The Project Approval and Management Framework is not fully implemented

7.63 In the 1990s, before the Agency had stable ongoing funding, the discipline imposed on it by government requirements for major capital projects made the setting and balancing of priorities relatively simple. However, the Agency's environment is changing, with a trend expected toward more and smaller projects. Management currently has two challenges: to determine relative priorities among competing project proposals and to monitor several projects under way at the same time. These challenges call for uniform project planning and management processes.

7.64 The Agency has developed a formal Project Approval and Management Framework for all projects. The Treasury Board approved the new project framework in March 2000 as a condition of increasing the Agency's delegated authority for project approval from $1 million to $5 million. The Agency's original target of March 2001 to complete the necessary documentation and fully implement the project framework was delayed a year because the Agency had underestimated the magnitude of the task; it is now being implemented in progressive phases. However, we noted that some project managers are resisting the framework because they believe the approval process is too onerous for smaller projects. The Agency advised us that it is reviewing the project framework in light of these concerns.

7.65 In our opinion, the project framework has the potential to improve the selection and management of projects. In the past it appeared that projects were selected on a basis other than their relative priority and contribution to corporate objectives. The Agency participates formally in many international meetings with NASA and the ESA, and its individual scientists attend various conferences. We noted that what were initiated as "in-house" investigations through such activities have led to participation in projects without adequate analysis of their downstream financial implications. Once initiated, these projects could become costly and difficult to abandon or downgrade.

7.66 **Recommendation.** The Agency should continue to refine its Project Approval and Management Framework to meet the needs of large and small projects and should ensure its full acceptance and use.

Agency's response. The Agency is reviewing and refining its Project Approval and Management Framework to better meet the needs of Agency project managers in their management of a wide range of projects. The Agency will implement the revised Project Approval and Management Framework by the end of 2003.

Human resources management

There is an urgent need to develop a strategic plan for human resources

7.67 The Agency's most valuable asset is its workforce. As a knowledge-based organization, it relies on the quality of its workforce to reach its objectives. The Agency's success thus depends in large part on its ability to attract, retain, and motivate the highly educated and specialized workforce it needs to carry out its activities. We therefore expected the Agency to have a means of ensuring that it has the right number of people with the right knowledge, skills, and abilities in the right place and at the right time.

7.68 The Agency has considered increasing the number of indeterminate employees since it obtained its stable ongoing funding in 1999. As already noted, funding in the past was based on major capital projects with a life-span of about 15 years. The Agency made extensive use of term employees and contract workers for space-related activities in the design, development, implementation, and operation of its projects. In December 2001, more than 50 percent of entry-level staff in engineering and computer science positions were term employees. Today, the Agency believes that its new initiatives and projects, together with stable ongoing funding, can allow it to increase its indeterminate workforce.

7.69 Effective human resources planning should give the Agency's senior managers a clear picture of human resources needs in both the short and the long terms. Analysis of current resources and future needs would allow for optimal and timely decisions by management to ensure that it has the staff it needs at the right time.

7.70 The Agency approved a human resources management framework in December 1999 that recognizes as one criterion for success its awareness of present and future human resources requirements and its ability to address the gap between the human resources it has and those it needs. It also identified the planning of human resources management as a performance indicator and an important element of its business plan that must be integrated into the Agency's planning process.

7.71 The Human Resources Directorate developed human resources guidelines and provided managers with several notable tools, all of which are located on the Agency's intranet site. The planning guideline indicates that senior managers should submit their objectives and their human resources plans annually and report their results to the President. The President establishes annual corporate priorities. One of the President's priorities for 2000–01 called for all senior managers to prepare human resources plans, succession plans, and career and training plans. The plans were to describe current staff shortages and future staff needs. The planning guideline also suggests that once a year a committee of senior managers review the human resources plans and establish objectives for human resources management over the following fiscal year. This committee will also develop guidelines on how to prepare human resources plans.

The Agency has neither a demographic profile of its workforce nor a comprehensive human resources plan

7.72 Given the success criteria outlined in the human resources management framework, we expected the Agency to have a comprehensive human resources plan based on a demographic analysis and integrated with its strategic and operational plans.

7.73 However, we found that the Agency has never produced a demographic profile of its current workforce that would allow it to project its emerging requirements for workforce renewal on a short-term and long-term basis. A demographic profile usually shows the workforce by age, gender, type of employment, occupational group and level, annual salary, years of service for pension eligibility, organizational unit, and region of work. One objective of a demographic profile is to illustrate an organization's demographic risks and prepare the organization to make better decisions in human resources planning. Producing a demographic profile would help the Agency to better analyze its needs.

7.74 We also found that the human resources information system, to which managers do not have access, is not integrated with other information systems. Furthermore, the Agency has not prepared guidelines, tools, or reference documents for managers on how to perform demographic analyses, trend analyses, and forecasts for short-term and long-term planning. Nor has it given managers the data to make such forecasts. Without systems and practices to quickly identify current resources and competencies, the Agency may hire staff it does not need or may fail to meet immediate needs, or it may simply evaluate its present capacity incorrectly.

7.75 At the same time, most senior managers we met with had a fairly comprehensive system of tracking their immediate and short-term staffing needs and related staffing actions, which are monitored closely. The Agency's human resources planning guideline states that a comprehensive plan should be submitted to the Executive Committee, or to a human resources committee composed of senior managers and human resources advisors, for discussion and approval of needs. In approving the Human Resources Management framework, the Executive Committee requested that key human resources priorities be identified for 2000–01. Despite the Executive Committee's request and the President's stated priority, we found no comprehensive human resources plan at either the directorate or the corporate level that identified the Agency's needs for 2000–01 or 2001–02. We also noted that the recommended human resources committee has not yet been established.

7.76 As a consequence of having no comprehensive human resources plan, managers can identify staff shortages or surpluses only when specific project activities are assigned. This means that senior managers do not have the information they need, for example, to develop a recruitment strategy and find sources of funding. At present, the Agency does not have a clear picture of its future needs; essentially, it fills vacancies as they arise. Most managers told us it is much faster and easier to cover shortages with contract workers. However, employees and union representatives complained that they are losing opportunities for professional development to contract workers.

A substantial workforce increase is under way despite the absence of a strategic plan

7.77 The Agency decided to normalize its workforce profile in February 2002 and announced that by December 2002, functions performed over time by contract workers and term employees would be converted to indeterminate positions. This conversion exercise involves 240 positions, about half of which are now filled by term employees. About 120 positions will be staffed through competitions. In February 2002, the Human Resources Directorate presented its recruitment strategy to the Executive Committee, including the number of positions identified by senior managers as critical to their operations.

7.78 Despite the absence of a comprehensive human resources plan, we expected to find an analysis of future needs as part of this special exercise to increase the indeterminate workforce. However, we found no such analysis, and only one directorate out of 14 has analyzed the effect on its budget envelope of converting its contract workers to employees. That directorate's analysis revealed that converting 40 contract workers (representing five occupational groups) could save between $1.2 million and $1.9 million. This single analysis cannot be extrapolated, however, because the directorate is not representative of the Agency's 20 occupational groups affected by the exercise. Nevertheless, it does indicate that the conversion of contract workers to employees should result in substantial savings.

7.79 However, the proposed conversion is not merely a question of cost savings. Before proceeding further with this conversion exercise, the Agency needs to align the projects planned for the short and the long terms with its present competencies and identify clearly the additional resources it needs. The absence of a strategic and comprehensive human resources plan seriously hinders its ability to do that.

7.80 We are concerned about the lack of succession planning in the Agency. Many senior managers were able to identify someone in their groups who could replace them. However, we found no written plan—one of the President's priorities. Senior managers tended to consider only those on their own teams as possible successors. Planning for succession means correctly assessing and strengthening the capacity to build and maintain a pool of employees who have the competencies essential to the Agency's programs. Vacancies in key positions must first be foreseen and then filled to meet future strategic needs.

7.81 We are also concerned about performance management in the Agency and the lack of career and training plans. Senior management explained that it is easier to replace contract workers than permanent employees if their professional competencies are not satisfactory. In the future, when permanent employees are covered by a collective agreement that gives them certain rights, it will not be as easy for the Agency to remove them. Therefore, before it hires employees the Agency needs to ensure that they have the professional and managerial competencies to perform their current functions. Then it needs to provide them with a career development program that will allow them to grow within the organization. The Agency is currently improving its performance management system and has created skills inventories to deal better with its conversion exercise. However, it has not yet adopted competency profiles that are linked with career and training plans.

7.82 There are other challenges that could affect the timetable for acquiring these new employees by December 2002. The Agency's recruitment strategy identifies employment equity goals but does not identify the potential shortfalls in the labour force and the labour market. Moreover, managers recognize that the recruitment process can take as long as nine months before they can make an offer of employment.

7.83 **Recommendation.** The Agency should produce a demographic profile of its workforce, develop a comprehensive and strategic human resources plan integrated with its operational plans and strategic objectives, and finish implementing its human resources management framework.

Agency's response. The Canadian Space Agency is both a young organization and one in transition. The Agency is committed to developing and implementing an integrated approach to human resources management that will ensure its continued ability to recruit, retain, and develop the professional expertise it requires to deliver its objectives through the Canadian Space Program. The less-than-full implementation of an integrated human resources management system in the past has not compromised the Agency in attaining excellence while meeting its objectives.

7.84 **Recommendation.** The Agency should consider delaying its staff conversion exercise until it has developed its strategic human resources plan.

Agency's response. A Canadian Space Agency human resources plan will be developed by late 2003. In parallel with the development of this plan, the conversion of term and contract staff to a stable workforce will reduce costs, while immeasurably contributing to strengthening the Public Service through the recruitment, development, and retention of a highly professional and capable workforce.

Performance measurement

The performance measurement process requires improvement

7.85 The Agency enjoys a strong reputation for excellence. Although it is not a large organization, its programs are highly visible nationally and internationally. They are a source of pride for most Canadians and have earned Canada worldwide recognition in the space industry. Public opinion surveys commissioned by the Agency demonstrate that Canadians consider it important to have a Canadian space agency and that the Agency's work is important to Canada.

7.86 The Agency maintains strong relationships with its international partners. In spite of its limited budget, it is well respected for its contributions in partnership with other space agencies. Our discussions with senior officials in other space agencies confirmed that the Agency enjoys an excellent international reputation. It has also been commended by its partners for its technical competence, the professionalism of its staff, and the importance of its technological contributions to their space programs.

7.87 The Agency has experienced little difficulty in reporting to Parliament on its many highly visible achievements. However, we are concerned that its current reporting practices do not provide Parliament with a complete overview of how its performance measures up to the strategic outcomes expected of it.

Reporting of performance is incomplete and not linked to strategic outcomes

7.88 The Agency faces difficult choices in selecting which programs and projects to fund. Having good information on past results can be useful for making these choices and for deciding to terminate some activities or reallocate resources. Solid information on performance is also needed to hold managers accountable for results and to communicate to Parliament and to stakeholders how well the Agency is managing its resources and meeting its corporate objectives.

7.89 The Treasury Board approved seven desired strategic outcomes developed by the Agency, and the Agency is accountable to report to Parliament on its performance against them. They are:

- economic benefits,
- understanding of the environment and contribution to sustainable development,
- technological development and diffusion,

- contribution to the quality of life,
- world-class space research,
- social and educational benefits for Canadians, and
- promotion and awareness of the Canadian Space Program.

7.90 We expected that the Agency would have a process for measuring the performance of its activities and their contribution to achieving the strategic outcomes. We found that the existing frameworks and documents do not provide information that adequately reflects the Agency's performance. Furthermore, the Agency has few performance indicators to measure the extent to which project activities contribute to its strategic objectives.

7.91 The Agency's primary tool for monitoring activities is its system of work plans, developed by directorates and approved by the Executive Committee; the plans are updated twice a year.

7.92 Work plans comprise an operational plan, linked to financial and non-financial information on activities and projects by service line; a description of the directorate's commitments, linked to corporate priorities; and multi-year financial information, showing the distribution of parliamentary appropriations by service line. In general, each directorate links all three of these work plan elements by project and service line in reporting to the Executive Committee.

7.93 Managers said they find work plans a useful basis for monitoring project activities. The twice-yearly updates also allow management to measure progress by project and by service line and to take quick corrective action as needed. However, we noted that work plans do not allow the Agency to identify clearly what a project contributes toward the seven strategic outcomes.

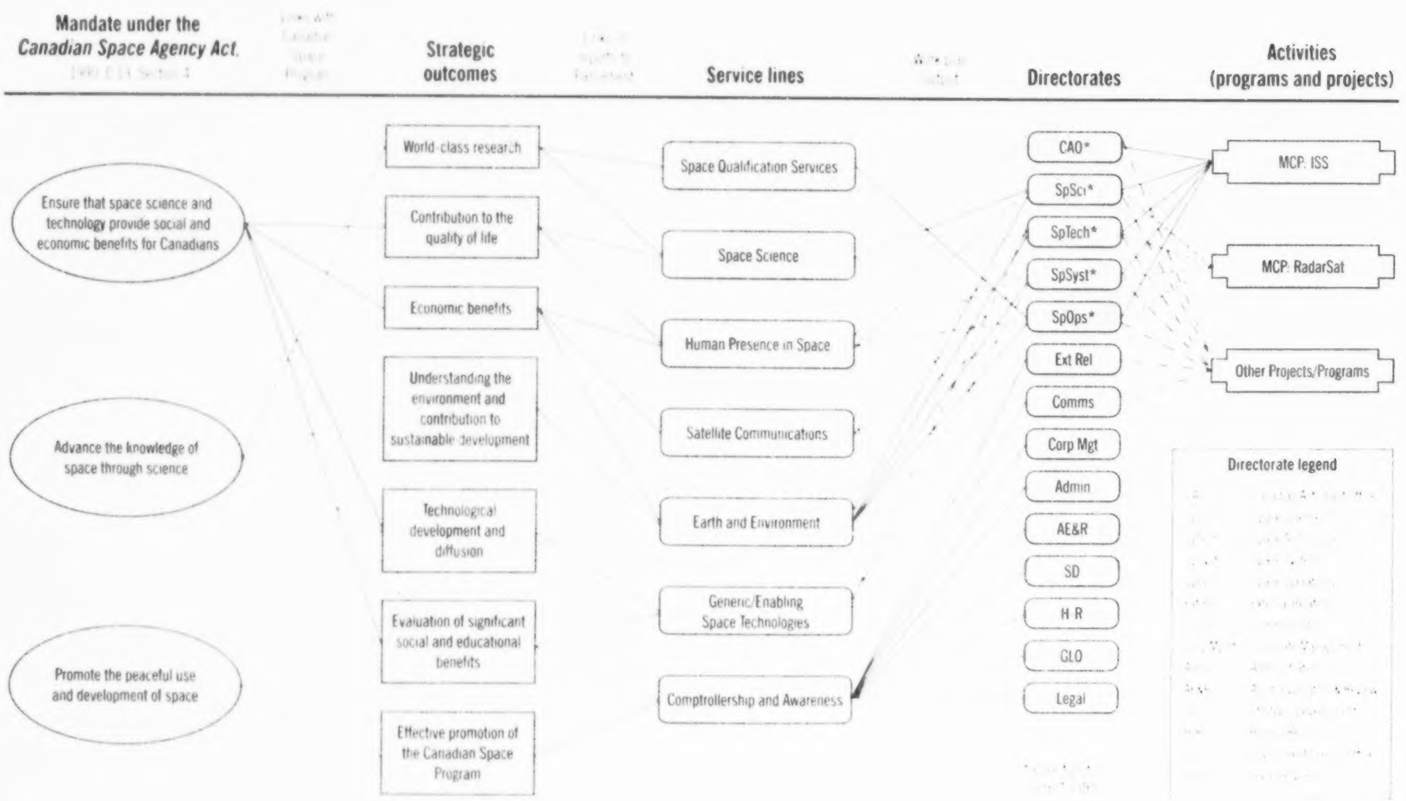
7.94 Appropriate indicators of performance are fundamental to good management of performance information. We expected the Agency to have performance indicators against which it could report on results.

7.95 Directorates do have performance indicators for project delivery, budgets, and milestones. However, they do not match projects with any of the seven strategic outcomes and have developed few performance indicators to measure progress toward them. In reporting to Parliament, the Agency arbitrarily matches the strategic outcomes with consolidated information from directorate reports.

7.96 The Agency recognizes the importance of reporting performance against the strategic outcomes and it has created a schematic illustration (Exhibit 7.4) of the links among its mandate, strategic outcomes, service lines, directorates, and activities (programs and projects).

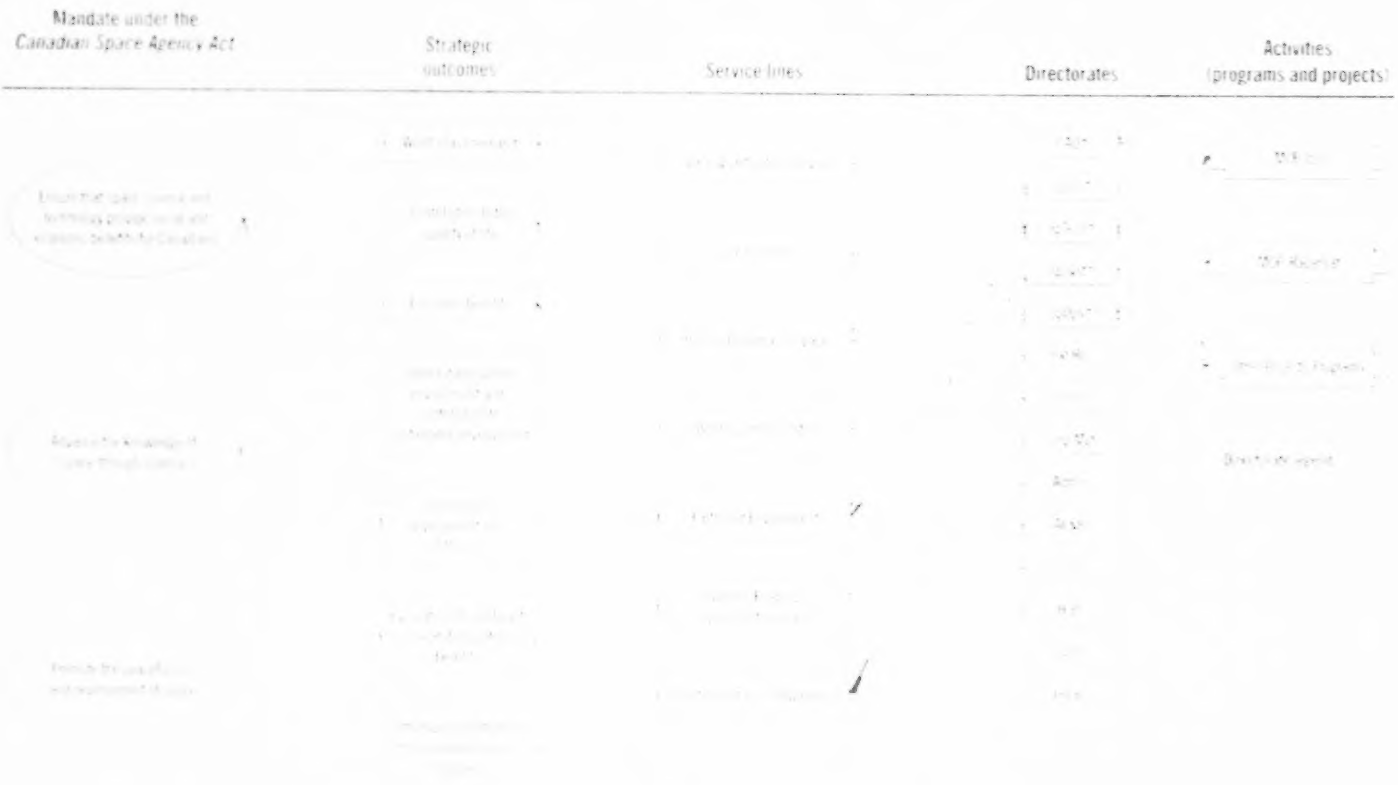
7.97 The Agency's illustration shows how projects contribute to each service line. However, its complexity makes it difficult to see how projects contribute to the Agency's mandate. Also, we are concerned that the arbitrary matching could leave gaps in the Agency's performance story and make it difficult for Parliament to assess whether the Agency is fulfilling its mandate.

Exhibit 7.4 How the Canadian Space Agency links its mandate, strategic outcomes, service lines, directorates, and activities (programs and projects)


Mandate under the *Canadian Space Agency Act*,
1990, C.13, Section 4
Strategic outcomes
Service lines
Directorates
Activities (programs and projects)
Ensure that space science and technology provide social and economic benefits for Canadians
Advance the knowledge of space through science
Promote the peaceful use and development of space
World-class research
Contribution to the quality of life
Economic benefits
Understanding the environment and contribution to sustainable development
Technological development and diffusion
Evaluation of significant social and educational benefits
Effective promotion of the Canadian Space Program
Space Qualification Services
Space Science
Human Presence in Space
Satellite Communications
Earth and Environment
Generic/Enabling Space Technologies
Comptrollership and Awareness
CAO*
SpSci*
SpTech*
SpSyst*
SpOps*
Ext Rel
Comms
Corp Mgt
Admin
AE&R
SD
H R
GLO
Legal
MCP: ISS
MCP: RadarSat
Other Projects/Programs
Directorate legend

Source: Canadian Space Agency

Exhibit 7.4 How the Canadian Space Agency links its mandate, strategic outcomes, service lines, directorates, and activities (programs and projects)


Mandate under the *Canadian Space Agency Act*
Strategic outcomes
Service lines
Directorates
Activities (programs and projects)

7.98 In our opinion, by better integrating the strategic outcomes into the existing performance measurement process, the Agency could develop appropriate performance indicators, measure the progress of projects toward strategic outcomes, and move closer to the results-based management approach it has adopted.

7.99 **Recommendation.** The Agency should improve its performance measurement process to ensure that its reporting to Parliament on performance is more comprehensive and linked to its strategic outcomes.

Agency's response. The Agency is committed to implementing the modern comptrollership initiative and will ensure more comprehensive reporting on its performance to Parliament. Actions are under way to enhance the performance measurement process, including the linking of performance with strategic outcomes.

Conclusion

7.100 We found that the Canadian Space Agency has been unable to meet the expectations for the Canadian Space Program fully, because its budget is limited by funding obligations that predate its creation. The Agency's project management and risk management practices are inconsistent, although generally sound, in projects over which it has prime responsibility and control. However, in its major Crown projects involving international partners it has been unable to escape the negative effects of program slippage and cost escalation.

7.101 The direct impact of the Agency's current budget shortfalls is that space science and technology activities proposed for the Canadian Space Program must be cancelled or deferred to keep the Agency operating within its budget. The current imbalance between its budget and its obligations under the Program could become even more serious in the near term, when the Agency begins paying its share of the costs of operating the International Space Station. Those costs could consume about a third of the Agency's current annual budget. It is clear that the Agency needs to resolve this imbalance by seeking an increase in its funding level or a reduction in the activities currently required under the Canadian Space Program.

7.102 The approval of a stable ongoing funding base in 1999 changed the Agency's operating environment to one that requires new management processes and practices. These include seeking appropriate involvement of stakeholders in developing a new strategic plan and assessing its long-term human resources needs; improving its measurement and reporting of performance; and conducting its annual priority review exercise from a longer-term corporate perspective. The Agency also needs to consult with stakeholders when a change in strategic direction is warranted.

7.103 The Agency's senior management understands the need for these changes and has indicated to us its intention to act on that need. Several change initiatives are under way now, but it will take time and sustained management support if the Agency is to make the required transition in its corporate culture and practices.

About the Audit

Objectives

The objectives of the audit were to assess the Canadian Space Agency's capacity to deliver the Canadian Space Program with due regard to economy, efficiency, and effectiveness; to provide the government and Parliament with an assessment of the Agency's response to its new funding environment; and to identify opportunities for improvement in the early stages of designing and implementing policies and procedures.

Scope and approach

The audit focussed on how the Agency manages its activities, programs, and human resources to support the delivery of the Canadian Space Program and the results the Program is expected to achieve. We reviewed the Agency's activities at its headquarters in Saint-Hubert and at its Ottawa facilities, and included discussions with its liaison staff in Washington and Paris.

We held discussions with senior officials of other space agencies both to gain perspective on the Agency's performance in the global space industry and its international partnership arrangements and to obtain information on best practices. These agencies included the U.S. National Aeronautics and Space Administration (NASA), the European Space Agency (ESA), the Centre National d'Études Spatiales (CNES), and the German Aerospace Center (DLR). We also met with officials of the European Commission and the U.S. General Accounting Office.

The audit included an extensive review of Agency documentation, including project briefs and approval documents from central agencies. We conducted many interviews with the Agency's senior management and with key external stakeholders. In reviewing the Agency's human resources management and performance measurement practices, we also conducted a number of focus groups with staff at middle and senior management levels. We observed several meetings of the Agency's internal management committees and external advisory committees. The management committees included the Executive Committee, the Enlarged Executive Committee, the Program Review Advisory Board, and the Core Function Coordinating Panel. The external advisory committees included the Canadian Space Agency Advisory Council and the Interdepartmental Committee on Space. We also attended briefings provided to Canadian industry representatives by senior officials of the European Space Agency.

Criteria

Our audit was based on the following criteria:

- The key components of the Space Program Management Framework should all be in place and operating as intended. Roles and responsibilities should be well understood by stakeholders and by Agency staff at all levels.
- The Agency should know who its key constituencies are, understand their needs, assess those needs against the goals of the Canadian Space Program, and set appropriate priorities and budgets.
- Management's strategic vision for the Agency should be consistent with the Canadian Space Program and should be communicated clearly to staff and stakeholders and understood by them. Decisions at all levels should be consistent with and supportive of the strategic vision.
- The Agency's submissions for approval of major capital projects should be based on objective business cases. It should monitor, evaluate, and report to decision makers on the costs, potential risks, and benefits of the major capital projects and their impact on other service line programs. The Agency should follow generally accepted principles of project management, as supported by the Project Management Institute, in overseeing projects contracted to Canadian industry and international partners.

- The Agency should have the financial and human resources capacity to implement its programs. It should have strategies for ensuring that it has the necessary human resources competencies where and when they are needed. It should also have strategies for allocating appropriate resources to enable programs to achieve expected results.
- The Agency's performance reporting should clearly indicate organizational strategies, performance expectations, and key results against the objectives and expected results identified in the Canadian Space Program.

Audit team

Assistant Auditor General: Richard Flageole
Principal: René Cyr
Director: Minh Hoang

Denise Coudry-Batalla
Geneviève Hivon
Robert Taylor

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Appendix A Canadian Space Station program — A brief history

In January 1984, the President of the United States directed the National Aeronautics and Space Administration (NASA) to develop and place in orbit within a decade a permanently manned space station, and invited friends and allies, including Canada, to participate in its development and use. By April 1986, Canada had confirmed to NASA its intention to participate in the International Space Station (ISS) program and had decided what its contribution would be.

In May 1988, Canada signed a formal agreement with the United States, member states of the European Space Agency, and Japan to participate in the ISS program. Each partner is required to build, operate, and maintain the equipment it contributes to the space station, and to pay a share of the common system operating costs. Canada committed to contributing the design, construction, and operation of a Mobile Servicing System.

In February 1990, the Treasury Board approved the funding of a major Crown project that included all activities to discharge Canada's obligations under its intergovernmental agreement. The initial project cost approved was $1.114 billion with a completion target of 2000, which was to include completion of the on-orbit assembly of the Mobile Servicing System and one year of initial operational verification. Canada would have ongoing operating and maintenance costs beyond the major Crown project for the 10-year planned life of the space station.

In 1994, the Russian Federation joined the ISS program. Also in 1994, domestic fiscal pressures led Canada to renegotiate its contributions to the ISS. However, this decision was revisited; in 1998 Canada signed an agreement to bring its commitment to $1.22 billion and extend the completion date of the Mobile Servicing System to 2001–02. In return, Canada has the right to use up to 2.3 percent of the space station's capabilities to conduct scientific and technological research.

The first two elements of the ISS were launched in November 1998 (Russian Zarya) and December 1998 (U.S. Unity). Slippage in the ISS assembly schedule in 1998 and 1999 meant further adjustments to the schedule and added to the costs of Canada's contribution. In February 2000, the Treasury Board approved a revised budget of $1.25 billion for the project and set a new target for completion in 2004–05.

In April 2001, Canada's first contribution to the ISS, the Canadarm2 (or Space Station Remote Manipulator System) was launched successfully. In June 2002, Canada's second contribution, the Mobile Base System, was also launched.

In 1984 the total cost of the ISS was estimated at about US$11 billion. By 2002 the cost had grown to about US$30 billion, with US$13 billion of that increase and a four-year slippage in schedules since 1995. Canada's contribution to the ISS is currently estimated to cost CAN$1.4 billion.

Appendix B RADARSAT program—A brief history

The concept of a space-borne Synthetic Aperture Radar (SAR) has been the main focus of Canada's Earth Observation Remote Sensing Program since a 1975 report to Cabinet, *Satellite and Sovereignty*. In 1980, following early trials using data from NASA, the Department of Energy, Mines and Resources (EMR) initiated preliminary technical and feasibility studies for the RADARSAT satellite, which would carry a remote sensing SAR.

The Synthetic Aperture Radar is a powerful microwave instrument that is able to transmit and receive signals through clouds, fog, smoke, and darkness and obtain high-quality images of the Earth in all weather.

In 1985, EMR submitted a proposal to Cabinet for a $770 million program that would include the United Kingdom and the United States as partners. Cabinet directed the Minister of Energy, Mines and Resources and the Minister of State for Science and Technology to seek ways of reducing the cost to the federal government through financial commitments from the provinces, the private sector, and international partners. In March 1988, the United Kingdom decided to withdraw from the program. The project was reconfigured and the costs reduced to $541 million between 1987 and 2000.

In March 1989, responsibility for the RADARSAT program was transferred by order-in-council to the new Canadian Space Agency. In June 1989, the Minister of State for Science and Technology was authorized to sign a memorandum of understanding with the United States partner agencies; Energy, Mines and Resources; Canadian provinces; and a private sector marketing and distribution organization.

In June 1994, Cabinet approved the Long-Term Space Plan II, which established Earth observation as a major thrust of the Canadian Space Program. The RADARSAT program brought Canada into the Earth observation business by providing operational and commercial services to users worldwide. The Space Plan directed the Agency to ensure the continuity of this service and to encourage increasing financial involvement by the private sector until the business is completely privatized.

Besides the commercial benefits, the government has a vital interest in the public-good aspects of RADARSAT for resource management, environmental monitoring, support for Canadian sovereignty in the Arctic, and support to foreign and defence policy around the world.

RADARSAT-1 was launched successfully in November 1995 and began its commercial operations in April 1996. It had an operational life expectancy of 5 years, later extended by 2.5 years to September 2003. However, the launch of RADARSAT-2 is now not expected before early 2004. In 2001, the estimated cost of the RADARSAT-1 project was $678 million; revenues from the sale of data were estimated at $87.5 million.

Report of the Auditor General of Canada to the House of Commons—December 2002

Main Table of Contents

Matters of Special Importance—2002
Foreword and Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada—Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada—Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

Appendices

2002

Report of the

Auditor General of Canada

to the House of Commons

DECEMBER

Chapter 8

Public Works and Government Services Canada—
Acquisition of Office Space

Office of the Auditor General of Canada

The December 2002 Report of the Auditor General of Canada comprises 11 chapters, Matters of Special Importance — 2002, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

Ce document est également disponible en français.

© Minister of Public Works and Government Services Canada 2002
Cat. No. FA1-2002/2-10E
ISBN 0-662-33114-1

Chapter

8

Public Works and Government Services Canada

Acquisition of Office Space

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

Table of Contents

Main Points 1

Introduction 3

A mandate to provide cost-effective office space for most public servants 3
Responsibility for acquiring office space is shared with client departments 3
Good planning and information are vital for cost-effective service delivery 5
Client expectations are changing 5
Focus of the audit 6

Observations and Recommendations 6

Planning for acquisition of office space 6
Key components of the long-term planning framework are not developed or implemented consistently 6
Many of the issues are not new 7

Acquiring office space and managing demand 8
Demand management is a shared responsibility between the Real Property Services Branch and clients 8
Sharing of information is not timely 9
The Branch faces risks when client commitments are not secured 9
Decisions by client departments can limit the options available to the Branch 11
The Branch has a single point of contact for client departments 12
Management decisions are not documented consistently 13

Managing information 14
The Branch lacks complete and accurate information about the costs of its services 14

Managing performance and reporting to Parliament 15
A need for good measurement and reporting of performance 15
The Branch has the basic infrastructure for a reasonable system of performance management 16
Reporting to Parliament needs improvement 16
More can be done to ensure the quality of performance information 17
A change in the way of doing business 18

Conclusion 20

About the Audit 21

Public Works and Government Services Canada

Acquisition of Office Space

Main Points

8.1 The Real Property Services Branch of Public Works and Government Services Canada (PWGSC) still faces some strategic planning, management, and reporting challenges. For example, it still lacks key planning tools. Without regional plans and consistent national information on the supply of space, it is difficult to match available space with the needs of client departments; management of the Branch recognizes that this affects its strategic planning ability. Further, while the Branch has the basic infrastructure for a reasonable system of performance management, it needs to improve its reporting to Parliament on what it expects to achieve and what it has achieved.

8.2 The Branch needs to make better use of financial and operational information and improve the way it analyzes options, particularly those with longer-term implications. It has difficulty accessing cost information and needs to do more work on creating cost information by client. Because investment in real estate involves large sums of capital and large lease payments, it requires a long-term perspective. The Branch needs to consider fully all practical alternatives, including the full costs of each. Good information and full analysis of options are needed to deliver service effectively to client departments and agencies.

Background and other observations

8.3 Providing office accommodation for the federal public service is a complex and difficult task. The Real Property Services Branch of Public Works and Government Services Canada has developed a good framework for managing the office accommodation of most of 187,000 public service employees, for which it has annual funding of about $1.7 billion.

8.4 Because it shares roles and responsibilities with client departments, the Branch does not control all the factors that affect the economy and efficiency of office space acquisition. Client departments can and do make decisions that limit the Branch's ability to adopt what it believes are the most cost-effective solutions. However, the Real Property Services Branch does have an important role to play, and it needs to improve the way it manages several aspects of its responsibility.

8.5 The Branch has had to adjust to changes in the public service—which went from downsizing in the 1990s to expansion in 2001—and take into account the availability of space vacated by the high-technology sector in the National Capital Region.

8.6 In 1991 and 1994, we reported that improvements were needed to obtain information on client requirements in a timely way and to develop long-term accommodation plans.

8.7 The Branch has begun to take a more proactive approach by looking at a portfolio of owned and leased buildings in a given area and forecasting the needs of all clients, rather than meeting needs client by client. According to client departments and Branch staff, it has improved its service delivery by establishing client service units as a single point of contact for client departments.

8.8 Although it has made some improvements in planning and management, the Branch faces long-standing challenges. It is important that it resolve them, given the significant level of resources it spends on office accommodation and its key role in supporting departments and agencies that deliver programs to Canadians.

The Department has responded. Public Works and Government Services Canada has agreed with our recommendations. Plans and actions it has under way are indicated in its responses in the chapter.

Introduction

A mandate to provide cost-effective office space for most public servants

8.9 Public Works and Government Services Canada (PWGSC) provides a wide range of common services to support client departments and agencies in achieving their program objectives. The Real Property Services Branch of the Department provides office accommodation to about 100 departments and agencies for most of 187,000 federal public service employees. It manages about 5.6 million square metres of space and provides leadership and stewardship for the management and administration of office facilities. Providing office accommodation for the federal public service is a complex and difficult task.

Did you know?

Number of public servants for whom the Real Property Services Branch manages office space **close to 187,000**

Number of square metres of office space it manages: **4 million**

8.10 The Branch, the Treasury Board and its Secretariat, and client departments share accountability for providing office accommodation. The *Federal Real Property and Federal Immovables Act* gives ministers the authority to administer real property. The Treasury Board has established several policies under the *Financial Administration Act* that provide further guidance on real property administration—the Common Services Policy, the Real Property Administration Policy, the Open and Fair Real Property Transactions Policy, and the Real Property Transactions, Processes, and Authorities Policy.

8.11 Under the *Department of Public Works and Government Services Act*, all federal real property that does not come under the administration of another minister, board, agency, or corporation is administered by Public Works and Government Services Canada. PWGSC is not responsible, for example, for office accommodation for Crown corporations. It is the designated custodian of office facilities, certain common-use facilities, infrastructures, and the Parliamentary Precinct. In specific circumstances PWGSC can collect revenues from client departments and agencies for its services in administering federal real property.

Responsibility for acquiring office space is shared with client departments

8.12 The Real Property Services Branch of PWGSC attempts to find solutions that meet the needs of client departments. It identifies options that, depending on the nature of the need, can include short-term leases or longer-term solutions such as purchased space, lease-purchase arrangements, or long-term leases. The most cost-effective solution may involve moving a client department's staff to a different building—or it could mean keeping them where they are.

8.13 Although the Branch attempts to find the most cost-effective way to meet their needs, client departments can decline to accept its proposed solutions. The total cost of office accommodation therefore depends on a combination of decisions, some of them made by client departments.

8.14 The Branch manages office accommodation in some 2,500 locations across Canada, with about 250 sites in Crown-owned office buildings. It made around 750 lease transactions in each of 1999–2000 and 2000–01. Of the 5.6 million square metres or so of the total space managed by the Branch, 54 percent is Crown-owned, 38 percent is leased, and 8 percent is lease-purchased accommodation. Four million square metres is office space. The remaining 1.6 million square metres is special-purpose space such as laboratories and warehouses. The Branch manages its inventory of space and acquires new space through construction, acquisition, and leasing. Its responsibilities include providing strategic accommodation services so client departments and agencies can focus on delivering their programs efficiently.

8.15 **The Branch has different relationships with different types of clients.** Under the Treasury Board Real Property Management Framework Policy and the Common Services Policy, PWGSC is the designated custodian of general-purpose federal office facilities. The Real Property Services Branch provides a mandatory common service that is funded from a central appropriation. However, it also provides optional services to other custodian departments for a fee—architectural and engineering services, for example. Individual departments pay for those services out of their own budgets. The Branch manages the revenues and expenses of its optional services in a revolving fund.

8.16 While most departments do not pay for the Branch's office accommodation services, it does have reimbursing clients—Human Resources Development Canada (HRDC), for example—who pay the Branch for accommodation services from their own budgets. Status as a reimbursing client is determined in legislation or in policy. Unlike custodian departments who manage and pay for their space, most reimbursing clients do not have the option of going to the private sector for office accommodation because it is a mandatory common service in the federal government, unless an exemption is granted.

8.17 The Branch's appropriation funding covers base building costs in Crown-owned assets—those related to the buildings' life cycle operation, maintenance, repair, and capital improvement—and the lease and fit-up costs of leased assets. Clients are responsible for equipment and furniture costs.

8.18 The Real Property Services Branch controls the use of space through space envelopes. As a result of the federal Program Review and the PWGSC's Shared Accommodation Leadership framework, a space envelope was established for each department, based on its office holdings in 1995; the Branch manages the envelopes. When a federal department or agency requires additional space, it can be financed in two ways. One way is to obtain the Treasury Board's approval for an increase in the Branch's appropriation to pay for office accommodation costs associated with a new program. The other way is for departments and agencies to pay for the additional space from their own budgets.

8.19 Just as the space envelopes limit the quantity of space the Branch will fund for each department and agency, the Branch also limits the quality of office accommodation. It will fund only a certain portion of office improvements, based on its fit-up standards. For additional space or extra fit-up that exceeds the established standards, client departments must pay from their own budgets.

Did you know?

Amount the Branch spends for accommodation each year: **$1.7 billion**

8.20 The funds that the Branch planned to spend in 2001–02 totalled $2.45 billion. Of that amount, $257 million would come from the reimbursing clients of the Branch and $1.448 billion from a central appropriation, for gross spending of $1.705 billion (Exhibit 8.1). The remaining $745 million would come from revenues received from custodian departments and managed through the revolving fund.

Exhibit 8.1 Summary of planned spending by the Real Property Services Branch for 2001–02

Planned spending	2001–02 ($ millions)
Crown-owned office buildings—maintenance and construction	654
Leased office accommodation	581
Lease-purchase office accommodation	135
Overhead salaries and costs not billable to clients	156
Payment in lieu of taxes	123
Bridges and highways	56
Gross spending	**1,705**

Source: Real Property Services Branch

Good planning and information are vital for cost-effective service delivery

8.21 To manage its financial resources, the Real Property Services Branch needs timely and accurate forecasts against planned budgets. To manage office accommodation effectively, it works with client departments to maintain accurate information on its inventory of space and the supply available on the market and to forecast client demands. With many leases, tenants, and accommodation costs to manage, the Branch needs to have good information and accurate, timely billing procedures to charge for its services.

Client expectations are changing

8.22 The Branch is operating in a changing environment. In May 1998 it began to contract out property management services in many government buildings. HRDC, one of its two largest client departments, became a fully reimbursing client in 1997; the other, the Canada Customs and Revenue Agency, has authority through its enabling legislation to manage its own accommodation. Currently, with the Treasury Board Secretariat and PWGSC, it is examining the funding arrangements associated with becoming a reimbursing client. As a reimbursing client, the Agency would pay for the cost of its office space and not the Branch. In some of PWGSC's regions, these two clients account for about 50 percent of the Branch's business.

[illegible]

Did you know? [illegible]

8.20 [illegible]

Exhibit 8.1 Summary of planned spending by the Real Property Services Branch for 2001–02

Planned spending	2001–02 ($ millions)
Crown-owned office buildings [illegible]	[illegible]
Leased office accommodation	[illegible]
Lease-purchase office accommodation	[illegible]
Overhead, salaries and [illegible]	[illegible]
Payments in lieu of taxes	[illegible]
Bridges and highways	[illegible]
Gross spending	1,705

Good planning and information are vital for cost-effective service delivery

8.21 [illegible]

Client expectations are changing

8.22 [illegible] HRDC [illegible] PWGSC [illegible] these two clients account for about [illegible] percent of the Branch's business.

All client departments are demanding more timely service and better accounting for real property services; reimbursing clients are becoming more involved in their real property investment decisions.

Focus of the audit

The **National Capital Area**—This refers to the region of the Department that administers accommodation services in the geographical region known as the National Capital Region

8.23 The audit focussed on the planning, acquisition, and management practices of the Real Property Services Branch of PWGSC in providing office space for federal employees. We did not audit disposals or major Crown projects. We selected and reviewed a sample of transactions in four of the Department's regions, including the National Capital Area. Further details on our audit can be found at the end of the chapter in About the Audit.

Observations and Recommendations

Planning for acquisition of office space

8.24 It is a major challenge for the Real Property Services Branch to balance the needs and demands of about 100 government departments and agencies with the supply of office accommodation in its own inventory and on the market. Office space becomes available at different times, in different regions, and in different quantities. It is a difficult task to reconcile the space available with the specific needs of a department for a particular type of space in a given location at a specified time. Good information is required to plan for meeting the needs of departments and agencies with the space that will be available when they need it.

8.25 In particular, the Branch needs to have good supply information—information about the space available on the market and the space it already has in its excess inventory. We expected to find that the Branch collects and uses supply information to take advantage of opportunities in the market and to plan for Crown construction where appropriate.

8.26 We found that the Branch has a variety of tools designed to provide the information it needs for strategic planning. These tools are important, because they provide key information such as market conditions and potential supply and demand—information the Branch needs to support its investment decisions. This information is developed through strategic plans at the community, regional, and national levels.

Key components of the long-term planning framework are not developed or implemented consistently

8.27 Although we expected that the Branch would provide clear guidance on strategic planning, we found that its planning framework does not spell out clearly what supply information the National Capital Area and the regions should use in their planning and how they should use it. For example, the regions do not routinely prepare a regional investment strategy, and the Branch's policy framework gives no guidance on when they are expected to do so. The Community Based Investment Strategy is used to obtain information on the supply of space by major city; it looks at the current supply and demand and at the anticipated needs of a client and recommends one of three options: construction, acquisition, or leasing. It also looks at major trends and vacancy rates in the local supply.

8.28 The Community Based Investment Strategy is not prepared and used systematically: it is to be prepared for a specific city or community and used to consider more immediate regional priorities. At least once every five years, its planning assumptions and other variables are supposed to undergo a complete review. However, 4 of the 13 Community Based Investment Strategies we saw were more than five years old. Furthermore, a Community Based Investment Strategy had not been developed or implemented in all markets. For example, at the time of our audit there was no up-to-date strategy for Montréal or Québec. In addition, the Community Based Investment Strategy for the National Capital Region was no longer relevant: its recommendations had assumed a demand that was no longer valid. That is, it had not anticipated the growth occurring in the National Capital Region; it had assumed that downsizing would continue. The National Capital Area of PWGSC has not implemented the strategy because it has not determined how it will implement the recommendations. Its Community Based Investment Strategy states that components such as the leasing strategy and a retrofit plan need to be developed before the strategy can be implemented. Those critical components have not yet been developed. We also observed instances where the Branch's oversight committees had deferred decisions to recommend projects because there was no relevant Community Based Investment Strategy to assess whether the proposed investments were consistent with the available information on supply and demand.

Many of the issues are not new

8.29 In 1991, our Office reported on the planning and leasing of office accommodation by what was then the Department of Public Works. In 1994 we reported on the management and operation of Crown-owned office buildings by Public Works and Government Services Canada and custodian departments. We made several recommendations for action by the Department to define user requirements early, improve delivery times, and manage lease costs better. We also recommended that the Department improve financial and operational performance information so it could manage its resources for office accommodation more effectively.

8.30 In 1998, PWGSC's own internal audit function concluded that elements of the long-term capital planning process were not working as they should. It noted that many key planning documents either had not been developed or were outdated. The documents that did exist were not used consistently or linked to each other.

8.31 Without regional plans and consistent national information on supply, it is difficult for the Branch to match available space with the needs of client departments. Management recognizes that this affects its strategic planning ability.

8.32 **Recommendation.** The Real Property Services Branch of Public Works and Government Services Canada should fully implement its own planning framework and investment strategy for office accommodation. It should ensure that all strategic documents are prepared in a timely way and the strategies implemented.

Department's response. Agreed. The Real Property Services Branch has already undertaken to develop and update Community Based Investment Strategies. The Branch will also review its regional investment plans and link them to Community Based Investment Strategies.

Acquiring office space and managing demand

Demand management is a shared responsibility between the Real Property Services Branch and clients

8.33 The Real Property Services Branch relies on client departments to give it accurate information on their requirements for office space far enough ahead that it can consider all possible solutions. We expected to find that the Branch collects accurate and current information on the demand for office space and uses it to meet its clients' current needs, to anticipate and plan for future needs, and to select the best accommodation choice based on a full analysis of options.

8.34 The Branch's accommodation policy framework indicates that the master occupancy agreement (MOA) is the primary accountability instrument between departments, agencies, and the Branch. An MOA sets out roles and responsibilities, and the department or agency agrees to co-operate with the Branch in identifying its future needs. The master occupancy agreement shifts some of the responsibility from the service provider to the client, freeing the Branch to concentrate more of its energy and resources on meeting the client's needs. The MOA is important because the Branch cannot by itself develop a long-term, national accommodation strategy by department and agency. As a starting point to put the MOAs in place, the Branch also needs accurate information on its national inventory of space and project information about each client.

8.35 The Branch made a commitment in 1991 to enter into national agreements with federal departments and agencies. However, currently it has master occupancy agreements with only 5 of the 100 or so departments and agencies. While management states that the specifics of the agreements have changed since 1991, it does recognize that MOAs are still important. It says that some are currently being developed and more need to be negotiated.

8.36 The Branch has not yet developed long-term accommodation plans by department and agency; and it needs to do this so the Branch and its clients can plan ahead and optimize the cost-effectiveness of their office accommodation. We understand that some departments, including HRDC and Health Canada, are working with the Branch to develop such long-term plans.

8.37 **Recommendation.** The Real Property Services Branch should follow its own policy and work with departments and agencies to develop national accommodation plans and master occupancy agreements.

Department's response. Agreed. The Real Property Services Branch will endeavour to develop more memoranda of agreement, starting with our larger clients, however, it should be noted that this requires the co-operation and commitment of our clients.

Sharing of information is not timely

8.38 Staff of the Branch told us that often they do not get timely information on the demand for accommodation and that client departments' requirements can change during the accommodation process. Getting information late on user requirements or having requirements change late in the process limits the Branch's options — building or buying requires more lead time than leasing. There is also a risk that the Branch will pay rent without having a tenant if, during the accommodation process, a client should change its mind about moving.

8.39 We found that the Branch lacks a systematic process to monitor the timeliness of transactions, the lead time it is given by clients, and the time needed to respond to requirements.

8.40 The Branch knows the renewal dates of leases, but it does not use that information as a basis to plan ahead systematically. Although its policy framework states that the accommodation process needs to allow for enough time, we found little in the Branch's office accommodation and leasing framework that explained when the process should start. The process has no formal mechanism that automatically triggers the contacting of the client and the beginning of the options analysis.

8.41 Staff of the Branch told us that 18 months is generally enough time to consider buy or lease options. We found in 47 percent of the files we examined that the process had started earlier than 18 months ahead, and later than that in the rest. Of 13 cases where the lease rate was higher than market rates, 4 were cases in which the Branch had run out of time to consider buy or build options.

8.42 In reviewing decisions of oversight committees, we observed some cases in which clients had failed to provide the needed input and commitment to the Branch on time. Getting information early from clients about their future requirements has long been a challenge for the Branch. Management believes that the situation has improved somewhat with the establishment of client service units (discussed later in this chapter).

8.43 Other factors affect the Branch's capacity for timely response to the needs of client departments. For example, its staff told us the Branch first learns that departmental programs will expand only after the Treasury Board has made those decisions. This gives the Branch little lead time to acquire the additional space that is needed. Client departments need to communicate their requirements as early as possible.

The Branch faces risks when client commitments are not secured

8.44 The Branch often acquires space to meet a specific demand; that is, it already has an agreement with a client department to move into the space.

However, it has recently begun acquiring space prior to reaching agreements with specific clients to occupy the space. This can allow it to take advantage of opportunities to acquire property at favourable prices. Having space already available can also help shorten the time required to meet demands when they arise. At the same time, though, acquiring space before it has an agreement with a specific client means that the Branch risks paying rent for a space with no tenant if a department should change its mind about moving or decline to move into the acquired space.

8.45 We reviewed two cases in which the Branch had acquired general office space without having a commitment from a client.

8.46 In the first case, after leasing the space the Branch negotiated with a client department for several months and believed it was close to an agreement. However, the client department decided not to move to the building.

8.47 The Branch had leased the building already fitted for office space, and it was quickly able to identify another client department interested in the same type of space and in the same part of the National Capital Region. It now has a commitment from the new client to move in by a specified date. The Branch believes that in this case it successfully managed the risk involved in acquiring space without an identified client committed to occupancy.

8.48 In the second case, too, the Branch had leased space to meet a general demand. Construction was needed to add floors to the building before it would be suitable. This time, the Branch had great difficulty finding a client department willing to move into the space.

8.49 A potential client that it identified clearly did not want to move to a location in a part of the National Capital Region that far away. At the time public transit was cited as a big problem. It was not clear to us that the Branch had considered the issue adequately before acquiring the space. In fact, the file shows that it had anticipated a possible reluctance to move to that particular location.

8.50 Eventually, it was decided that the client would remain where it was. Another client was later identified and, if everything goes according to plan, that client is expected to move in December 2002. The occupancy date is 16 months later than the Branch initially planned.

8.51 Even if this move occurs as now planned, the Branch will have paid over $2.7 million in rent for an unoccupied building. In this case, the Branch had difficulty managing the risks involved in acquiring space without first identifying a client.

8.52 In the first case, the risk was mitigated because the condition and layout of the space were already close to what the eventual client needed. In addition, the space was located in a suitable area.

8.53 In the second case, the risk was much harder to manage. The building required construction and the location made it difficult to find clients. We are concerned that the Branch committed to a nine-year lease at this location despite early indications that finding a client would be a problem. Furthermore, the construction involved and the lack of an identified client and client requirements at the planning phase of the acquisition created a high risk that the space could not be ready in time.

8.54 As already noted, acquiring space prior to having an agreement with a client can yield benefits. However, the Branch needs to assess the likelihood of finding a client willing to occupy the property, and it needs to consider the risk of increased costs should a client not be found within a reasonable length of time.

Decisions by client departments can limit the options available to the Branch

8.55 A client department may insist that accommodation proposed by the Branch does not meet its operational requirements. In some cases, client departments insist on a specific location, in effect eliminating the Branch's role of seeking the best option. We observed cases in which client departments made it clear that they had no intention of moving from their current premises. In those cases, the Branch had to forgo finding solutions that might have been more cost-effective.

8.56 **Options analysis needs to include long-term costs of options.** Because investment in real estate involves large sums of capital and large lease payments, it often requires a long-term perspective. Treasury Board policies require the Branch to base its decisions on the long-term costs of available options. However, we found that it did not consider the option to buy or build but limited its analyses to the lease option—in some cases because it did not have enough lead time to consider all alternatives. In cases where no Crown-owned space was available, it also considered only the lease option.

8.57 The Branch's analyses compare the net present value of discounted cash flows for various options. We noted that the results of the comparison can be influenced by the term of the lease: a short-term lease appears to be less expensive than the buy or build option. Basing lease costs on the full time span over which a space will be leased would make the lease option more comparable with the buy option.

8.58 In the sample of 80 files we reviewed, there were 9 cases in which the Branch had been leasing the location for over 20 years. We are concerned that over the long term, lease renewals are not always the most economical option. We observed that in its options analysis, the Branch did not always use information on total lease payments or keep track of the original lease dates. The Branch did not monitor the full costs of leasing over the long term.

8.59 Although we recognize that its leasing decisions can be influenced by factors other than cost, such as the operational need for a client to stay in its current location or a lack of capital funding, the Branch needs to analyze fully all practical alternatives—including their full costs—before deciding on an option.

8.60 In some circumstances, the client has an only temporary need for which a longer-term solution would not be practical. For most ongoing needs, however, we are concerned that the Branch's methods of options analysis could favour continuing the renewal of short-term leases as the least expensive solution when actually it can be the more costly option over the long term.

8.61 **Recommendation.** The Real Property Services Branch should review its methods of options analysis to ensure, where practical, that long-term options are considered fully.

Department's response. Agreed. As stated in the chapter, the Real Property Services Branch has already changed its direction to a more proactive supply management approach based on portfolio acquisitions. This enables the Branch to acquire the right property, which will allow proper lead times to consider all investment options. The Branch will also put in place a process whereby expiring leases are flagged well in advance to ensure that all appropriate investment options can be analyzed when dealing with the replacement or renewal of the lease.

Preparing a full, long-term cost analysis is only the first step. When long-term benefits point to purchase or build options, the Treasury Board must be prepared to consider funding these options.

The Branch has a single point of contact for client departments

8.62 In 1995–96, the Branch was reorganized to simplify client service through a single window — the client service unit. According to PWGSC's internal audits, client departments and Branch staff generally viewed the organizational change positively. Client service units have a standing contact in each client department and agency. The units are supported by representatives from several centres of expertise: asset and facilities management services, architectural and engineering services, office accommodation and real estate services, strategic management, and policy framework and resource management. The client service units are located in PWGSC's five regions and its National Capital Area. Each client service unit works closely with facilities management staff in each department and agency.

8.63 **Role of Client Accommodation Services Advisor is key to managing demand.** As a provider of a specialized common service, the Branch needs skilled professionals who understand the real estate service and leasing industry. According to client departments and Branch staff, in consolidating various functions into client service units the Branch has improved its delivery of service. The Client Accommodation Services Advisor (CASA) is the client's primary contact in the client service unit for all its accommodation needs.

8.64 The CASA is responsible for getting timely information on the demand for space, is responsible for options analysis, and is the overall co-ordinator of services related to a client's lease renewal or its relocation. In some regions, however, both Branch management and client departments told us they are concerned that the CASAs may be overworked, affecting levels of service.

They feel that CASAs' responsibilities may be excessive and they may not have adequate tools, such as costing information, to carry out their duties efficiently. PWGSC's internal audit function recommended in 1998 that the CASAs be given more support to carry out their responsibilities. "The onus of making leasing work within the new business management model falls squarely on their shoulders," said the audit report.

8.65 The Branch has informed us that of 223 CASA positions, 55 were vacant in July 2002. It is looking at the workload and plans to review the CASAs' responsibilities.

Management decisions are not documented consistently

8.66 We reviewed a total of 80 sample files of the Branch from four of the Department's regions, including the National Capital Area. The Branch's policy requires its staff to complete investment analysis reports and market analysis reports for all new lease and lease renewal transactions.

8.67 **Important documents not kept on file consistently.** From our review of the sample, it appears that management does not systematically monitor key items of business such as the prices paid for leases and the timeliness of project completion. In the 80 files, we noted that 29 percent did not contain investment analysis reports and 34 percent lacked market analysis reports. After a search by the regional offices, the Branch provided us with information that we had not found in the files. Ultimately, 14 percent of the files were missing investment analysis reports and 21 percent were missing market analysis reports.

8.68 We are concerned about the files' lack of this information because it suggests that Branch employees who need it do not have the tools to do their jobs. Further, without market analysis reports the Branch cannot determine whether it is getting the best prices.

8.69 The Branch's policy requires the asset and facilities management sector to complete building performance reports once a year so the condition of leased buildings can be assessed. The information in these reports provides a basis for the Branch to assess whether landlords are meeting their responsibilities to maintain their buildings to the agreed standards. We examined building performance reports for premises leased in the National Capital Region.

8.70 In our sample of 19 leases we found that the Branch had received only 9 of the reports on building performance, and those provided only cursory information of questionable usefulness. The Branch needs to examine whether the current process for reviewing building performance is adequate to manage leased buildings.

8.71 **Recommendation.** The Real Property Services Branch should introduce more discipline and rigour into its collection and use of information, including demand information, in managing the acquisition of office space. It should ensure that the required reports are available to decision makers for each transaction and that decisions are fully documented.

Department's response. Agreed. As noted in the chapter, it is essential that clients identify their needs well in advance. The Real Property Services Branch will increase its efforts to gather client demand information earlier. The Branch will take steps to improve the timeliness and accuracy of the data in the Tenant Accommodation Demand System and ensure that files contain the appropriate reports. In addition, a new automated tool (RECAPP®) for measuring the condition of our own buildings is in the implementation stage.

Managing information

The Branch lacks complete and accurate information about the costs of its services

8.72 We expected the Branch to have adequate financial management and reporting capacity, including timely and accurate information, to manage its resources effectively and meet the needs of clients.

8.73 The Branch's clients who are funded by appropriations need to have sound information on their space envelopes so they know the costs they will have to pay. Fully reimbursing clients, such as HRDC, already know how much the Branch's services cost because they pay for them. Fully reimbursing clients are more demanding, have more information, and are better able to hold the Branch to account for dollars spent and results achieved.

8.74 The Branch recognizes that information systems are critical to support its principal business processes. It maintains business information in 16 national systems.

8.75 Both the Branch and client departments have recognized that the Branch's information systems have significant weaknesses. The Branch has identified the following concerns:

- existing systems are not positioned well to support the Branch's business management model;
- systems are not integrated and cohesive; and
- staff, management, and clients have difficulty accessing information in the Branch's systems when they need it. The Branch's ability to share system-based information with its clients and service delivery partners is limited.

About half of the managers we interviewed in 15 client departments have had problems with the timeliness of the Branch's billing and costing systems.

8.76 The Branch established the Business Information Taskforce in 1999 to address some of these concerns. The Taskforce examined information systems available on the market and found no single information system that could accommodate the complexities of the Branch's role as service provider and landlord. We noted that the Taskforce has not yet established target dates for resolving the major systems problems. The Branch informed us that it is developing strategies to help define user requirements and to expand and enhance data integrity; it is also considering other initiatives to help it improve its management of information.

8.77 In interviews at several of the Branch's client departments, we asked about the quality of service they receive from the Branch. Some departments said that the Branch is taking a more strategic approach and has improved the way it does business. However, others were unhappy with the quality of its financial information and its response times for projects. They expected the Branch to provide accurate information about project costs. Certain departments also expressed concern about the reliability of the Branch's information on the space they occupy.

8.78 The Branch does not know how much its services to each client cost. It needs to develop cost accounting and ensure that its operational information is complete and accurate. The Branch recognizes that it has difficulty accessing the cost information it needs to account completely for the cost of each centrally funded client's accommodation, including the cost of overhead and capital projects. The Branch is planning a pilot project on cost accounting for its services to HRDC this year.

8.79 Financial information for project management is a particular concern. A PWGSC internal audit in 1999 noted, "The total approved project amount which may be committed over several years is neither recorded in the Financial Management System (FMS) nor in the PBMS [Project Business Management System]." It further stated, "There is, however, no official system in use for monitoring the total project expenditure against the total amount approved for the project." We noted that the Branch is taking steps to improve the Project Business Management System.

8.80 Although the Branch is beginning to take corrective action, progress has been slow. Many of its staff believe that the Branch's systems do not provide accurate and complete information to meet their business needs. Staff told us that maintaining and using the systems is cumbersome and labour-intensive.

8.81 **Recommendation.** The Branch should develop an accurate management information system to ensure the completeness and accuracy of its financial and operational information.

Department's response. Agreed. Projects designed to improve information management are already under way at the Branch and sector levels. Improvements to the Facility Inventory System are already complete, and further improvements are being made to the Financial Management System.

Managing performance and reporting to Parliament

A need for good measurement and reporting of performance

8.82 Like other departments and agencies, PWGSC provides Parliament with information on its performance annually, in its performance report. The Real Property Services Branch provides performance information to its own staff in its *Business Bilan* publication. The 2001–02 mid-year edition of this publication presents 36 performance indicators under the headings Client Success, People, Assets, and Financial Success, giving management and staff information on performance, trends, opportunities, and responses for each indicator.

8.83 In examining certain aspects of the Branch's performance measurement and reporting, we expected to find appropriate information for use in decision making by management and staff. We also expected to see information provided to Parliament on the use of public money and the results achieved.

The Branch has the basic infrastructure for a reasonable system of performance management

8.84 The Branch involves managers in the development, use, and revision of performance information. It has identified key players and requirements for implementing a performance management system and has assigned a specific individual to lead and co-ordinate performance measurement. We encourage the Branch to continue its commitment to focussing on performance.

8.85 Performance measurement at the strategic level is a core function of the budget management process. We have noted that the Branch has done no study to determine clearly what resources are needed to collect performance information, what information is needed, how often it is needed, what information is available, and how well the Branch meets its information needs. The Branch's performance management function needs client and human resources information from Branch systems that are outside its control and influence.

8.86 **The Branch is beginning to use performance information in strategic planning.** The Branch's strategic framework integrates performance information with strategic planning processes to help managers understand the linkages between performance, planning, and budgeting and to influence their priorities.

8.87 Targets have been identified for most key performance indicators, and achievement against targets is reported twice a year. While it does not use performance information as part of day-to-day decision making, the Branch does have management agreements that include commitments to use quantitative performance information.

Reporting to Parliament needs improvement

8.88 We assessed the information on the Branch's performance published in PWGSC's 2000–01 *Performance Report*. We looked for a clear description of organizational context and strategic outcomes; clear and concrete expectations for performance; reporting of key results against expectations; support for the reliability of performance information; and demonstrated use of performance information—five criteria for a credible performance story. We found that the information in the performance report needs to be improved to meet the five criteria.

8.89 **Is there a clear description of organizational context and strategic outcome?** The Department and the Branch provided a clear picture of their operating environment, operations, and challenges. However, the Branch had not articulated clearly and in measurable terms what it expected to achieve; had not reported progress made in its performance; and had not made clear to

Parliament how the achievements it reported were linked to stated objectives. The Branch also failed to discuss the risks to achieving planned strategic outcomes, and it did not identify all key partners and their roles.

8.90 **Are performance expectations clear and concrete?** We found that few of the performance expectations specifically stated a direction for change (increase, maintain, or decrease), an amount (number or percent), and a time frame (for making a change).

8.91 **Are key results reported against expectations?** The Branch's section of the PWGSC performance report was relatively strong in aligning results with previously stated performance expectations. However, it did not discuss major challenges to achieving key results; nor did it provide the overall cost of the Branch's activities by planned strategic outcome.

8.92 **Is there support that indicates the reliability of the information in the performance report?** We found little in the performance report to help readers judge the accuracy of the information.

8.93 **Does the performance report demonstrate how the Branch has used its performance information?** We were unable to find examples demonstrating that performance information was used in decisions about the management of the Branch's services or strategies so it could deliver better results to Canadians.

8.94 **Recommendation.** The Real Property Services Branch should improve its reporting to Parliament. In particular, it should clearly articulate what it expects to achieve, report on its performance, and make clear to Parliament how the reported achievements are linked to stated objectives.

Department's response. Agreed. The Real Property Services Branch will develop an improved performance framework with clear statements of our expected achievements. In addition, the Branch will link the achievements to our strategic objectives.

More can be done to ensure the quality of performance information

8.95 The Branch continues to work toward ensuring that it has comparable, appropriate performance information by collaborating with other organizations in the private and the public sectors that are in the same line of business. For example, at an international conference on public sector workspace issues in June 2002, staff of the Branch presented a paper jointly with one of the Branch's business counterparts that serves both private and public interests.

8.96 The Branch undertakes and reports on surveys of client and tenant satisfaction. While the surveys themselves are well done, the sampling methodology does not facilitate year-to-year comparisons or allow for using the information to establish an overall measure of satisfaction. The Branch has committed to continuing its efforts to improve its survey practices.

8.97 The Treasury Board policy on transfer payments sets out an approach to performance measurement, which is similar to the Branch's own new performance measurement approach. Once fully implemented, the Branch's approach will help to move performance reporting beyond activities and outputs to outcomes and measures that are linked to stated objectives.

8.98 The Branch's performance measures are not well defined. Good definition establishes both an explanation of the measure and the methodology for its calculation. It is important that the definition contain enough information about the measure that it can be understood easily. It is also important that its calculation be described in enough detail to allow replication.

8.99 The Branch has not assessed its performance information systems to ensure that they are protected against unauthorized access and that adequate controls are in place to maintain data integrity. Nor have the systems been assessed—for example, through periodic audit—to ensure that performance information is valid, accurate, and reliable.

8.100 **Recommendation.** The Real Property Services Branch should ensure that it has clear and complete definitions of all performance measures and indicators. It should establish procedures to assess the accuracy and validity of all reported information on performance.

Department's response. Agreed.

A change in the way of doing business

8.101 During the federal Program Review in the 1990s, the Branch was operating in an environment of government downsizing and budget cuts. Given the decreasing size of the federal workforce, the Treasury Board called for a reduction in the amount of office accommodation. Funding was difficult to obtain for large capital projects, such as the construction or purchase of government offices. PWGSC had to adjust to these changes and plan accordingly. For example, the Community Based Investment Strategy for the National Capital Region was based on the assumption of a downsizing environment.

8.102 In early 2001, PWGSC faced two major changes. First, the government workforce began to expand, in sharp contrast to the downsizing that had marked the previous decade. Second, in the National Capital Region the downsizing of the high-technology sector meant that a significant number of properties became available. These changes have given the Branch an opportunity to make some longer-term strategic decisions.

8.103 The recent National Capital Area Supply Strategy framework is indicative of better long-term capital planning by the Branch. A series of submissions to the Treasury Board shows a proactive approach to developing a supply strategy in the National Capital Region. This new approach includes acquiring major capital assets, such as Ottawa's former City Hall and the Royal Bank Building, and taking advantage of the space vacated by the high-technology industry. Given that this market sector accounts for about 51 percent of the Branch's national inventory, it is critical that it be managed well.

8.104 Being more proactive is another aspect of the Branch's new approach. The Branch has begun to acquire space before it has firmly identified a department or agency as a tenant. This gives it some flexibility to take account of expiring leases and allows for any swing space needed while space in its inventory is rehabilitated. There are risks associated with this approach. As noted earlier, departments may decline to move into a particular building.

8.105 In recent years, the Community Based Investment Strategies have helped the Branch improve its long-term planning. It has detailed analyses of its inventory of space and a good forecast of client demand. Although the information in a Community Based Investment Strategy applies only to a specific city, the supply demand analysis approach is sound and the strategies lay a good groundwork for decisions about assets.

8.106 The Canada Customs and Revenue Agency is the largest client for the Branch's accommodation services. By becoming a reimbursing client, the Agency itself would manage funding of more than $223 million for accommodations. This would shift the present balance in the client service provider relationship and create new demands on the Branch to provide timely, good-quality service and account for the level of service it provides.

8.107 The Branch is taking steps to improve its information systems; it has established the Business Information Taskforce to examine the integration of business processes and information requirements. Charging clients user fees is a part of its management approach. Management believes it has a client-focussed business strategy and says it is keenly aware that its prime mandate is to provide responsive common service.

8.108 Management also says that the Branch hopes to provide better service and react more quickly to client needs by improving its costing, becoming more client-oriented, and improving its efficiency. A May 2002 assessment of departmental services suggests that PWGSC has made substantial progress over recent years in changing the culture of the Department as a whole, giving it a service orientation.

8.109 By engaging in strategic portfolio management, the Branch has begun to identify its best assets so it can target areas for long-term investment. It is also developing components of long-range plans and regional strategic action plans to help co-ordinate and integrate activities. The Branch believes that strategic portfolio management will reduce costs, improve efficiency, and help achieve full integration of the Branch's investment strategies.

8.110 The Branch's vision statement reflects the attitude of the organization: "To be recognized as adding value to achieving client and government objectives through the delivery of the most timely and affordable real property program and services." The Branch believes it has started to improve its efficiency and is working toward better value for money in its services by controlling the costs of the accommodation it provides. It is also examining risk management to ensure that risk is addressed from an organization-wide perspective as well as a Branch and a project perspective.

Conclusion

8.111 Providing office accommodation for the federal public service is a complex and difficult task. With $1.7 billion at its disposal and a mandate to provide a productive work environment for most of the 187,000 employees of the government, the Real Property Services Branch has a major responsibility. Effective planning and acquisition of office accommodation is a responsibility it shares with its client departments and agencies.

8.112 Over the years, we have reported to Parliament that the management of office accommodation needs attention. Our 1991 and 1994 reports recommended that needed improvements be made to obtain information on client space requirements in a timely way. We also recommended that long-term accommodation plans be developed.

8.113 While the Branch cannot always control the factors that affect the efficiency and economy of office space acquisition, it has an important role to play in managing the areas of responsibility that it can control. Improvements are needed in several areas.

8.114 The Branch's strategic planning still lacks some key elements. Without regional plans and consistent national information on the supply of office space, it is difficult to match available space with the needs of client departments. Management in the Branch recognizes that this affects its strategic planning ability. When clients do not identify their own requirements accurately and in a timely way, the Branch needs to take a different approach to forecast and respond to demand.

8.115 Because investment in real estate involves large sums of capital and large lease payments, it often requires a long-term perspective. Treasury Board policies require the Branch to base its investment decisions on the long-term costs of available options. However, we noted that its options analysis does not always look at complete life cycle costs or at all options. The Branch needs to review its methods of options analysis to ensure, where practical, that the long-term costs of options are considered fully.

8.116 The information systems of the Branch do not provide all of the tools needed to support its business processes. The Branch recognizes that it has difficulty accessing cost information and that additional work is needed to create cost information by client.

8.117 Client departments and Branch staff believe that the way the Branch has now organized itself has improved its service delivery. Client service units provide a single primary contact for departments and agencies. While the Branch needs to improve its reporting to Parliament further, it does have the basic infrastructure for a reasonable system of performance management.

8.118 Although the Branch is improving its management and planning processes, some of the concerns we have raised are long-standing. It is important that the Branch resolve them, given the significant level of resources it spends on office accommodation and its key role in supporting departments and agencies that deliver government programs to Canadians.

About the Audit

Objectives

The audit objectives were to determine the extent to which the Real Property Services Branch of Public Works and Government Services Canada

- exercises due regard to economy and efficiency in meeting its responsibilities for planning for and managing the acquisition of office space, and
- complies with applicable government regulations and policies in carrying out its office space acquisition activities.

Scope

We examined the Branch's operations in four of the Department's regions, including the National Capital Area. We reviewed systems, controls, and management practices related to the planning, acquisition, and management of office space. We also examined a sample of 80 transactions from the four regions. We did not audit the Parliamentary Precinct.

Criteria

We examined the Branch's planning, acquisition, and management of office space against the following criteria:

- The Branch should have appropriate tools available to anticipate future needs, analyze the range of available options, and support its decisions. These tools would include strategic plans and models, policies and guidance, and management information and processes related to office space acquisition.
- In taking action to meet the needs of client departments and agencies, the Branch should use the tools appropriately and consistently and follow relevant Acts and regulations, Treasury Board policies and guidelines, and departmental policies.
- The Branch should have and use performance measures to manage its activities, such as appropriate benchmarks and client satisfaction surveys. Performance management should include appropriate reporting to Parliament.
- The Branch should have complete and accurate management information and financial information to support decision making.

Audit team

Assistant Auditor General: Shahid Minto
Principal: Ronnie Campbell
Director: Sue Morgan

Tony Brigandi
Nadine Cormier
Brian O'Connell

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Report of the Auditor General of Canada to the House of Commons—December 2002

Main Table of Contents

Matters of Special Importance—2002
Foreword and Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada-Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada-Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

Appendices

2002

Report of the

Auditor General of Canada

to the House of Commons

DECEMBER

Chapter 9

Modernizing Accountability in the Public Sector

Office of the Auditor General of Canada

The December 2002 Report of the Auditor General of Canada comprises 11 chapters, Matters of Special Importance—2002, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

Ce document est également disponible en français.

© Minister of Public Works and Government Services Canada 2002
Cat. No. FA1-2002/2-17E
ISBN 0-662-33115-X

Chapter

9

Modernizing Accountability in the Public Sector

Table of Contents

Main Points 1

Introduction 3

Focus of the study 3

Observations 4

Accountability and the new public management 4

Focus on results 4

Delivery through partnering 4

Increased discretion, flexibility, and innovation 5

Accountability enhanced 5

Principles of effective accountability 7

The light of transparency 7

The accountability process 8

An accountability framework 9

Holding to account 10

Accountability in today's public sector 13

Accountability for performance: Results and means 13

Accountability in partnering arrangements 14

Accountability with increased discretion and flexibility: A learning public service 16

Strengthening Parliament's role 17

Conclusion 18

About the Study 20

Modernizing Accountability in the Public Sector

Main Points

9.1 This chapter proposes an enhanced definition of accountability that takes modern developments in public management and governance into account:

> Accountability is a relationship based on obligations to demonstrate, review, and take responsibility for performance, both the results achieved in light of agreed expectations and the means used.

9.2 This definition of accountability is consistent with managing for results, allows for accountability among partners who might be equal and/or independent, and includes obligations for all parties in the accountability relationship. It emphasizes the importance of accountability for results and for the means used. It underlines that effective accountability is not just reporting performance; it also requires review, including appropriate corrective actions and consequences for individuals.

9.3 In addition, we outline five principles of effective accountability: clear roles and responsibilities; clear performance expectations; a balance of expectations with capacities; credible reporting; and reasonable review of performance, with adjustment. These principles can be applied to a wide range of accountability relationships, but their use needs to be tailored specifically to each relationship.

9.4 Accountability would be strengthened if Parliament played a more active role in scrutinizing the government's plans and performance expectations and comparing them with the performance reported later by the government.

9.5 Transparency is essential to accountability, making it easier for those outside government to monitor and challenge the government's performance for consistency with policy intentions, for fairness, for propriety, and for good stewardship. The prospect of scrutiny also helps keep ministers and managers of public programs (public servants as well as their partners in program delivery) attuned to the defensibility of their actions.

Background and other observations

9.6 In our representative democratic system, accountability legitimizes the government's right to govern. Parliament holds the government to account for the legitimate use of authority. Ministers are held to account in Parliament, and they, in turn, hold their officials to account for the delivery of public policy.

9.7 Traditional accountability practices are under pressure by developments in public management and governance—a focus on getting results, using partnering arrangements, and developing a flexible and innovative public service.

9.8 Just what can ministers and managers reasonably be held to account for, when managing is focussed on results—and in particular on outcomes, over which control and influence are limited? We think they can reasonably be held accountable for demonstrating the extent to which the results they expect are being accomplished, the contribution their activities have made to the actual outcomes, the lessons that have been learned, and the soundness and propriety of their actions.

9.9 In partnering arrangements—used increasingly by governments to deliver public programs—accountability can become diffused. In our view, these arrangements require more and not less accountability. Each partner is accountable not only to its own superior or governing body but also to the other partners in the arrangement. Together, they are accountable to their joint co-ordinating body or, in some cases, to the public for the arrangement's operation and success.

9.10 A degree of discretion and flexibility allows managers of public programs to take reasonable risks in order to innovate. If it is based solely on compliance with too many and unneeded rules and procedures, accountability cannot easily incorporate risk. Accountability must be able to tolerate mistakes or adverse results, provided that any risk taken can be shown to have been reasonable and the management of the risk to have been sound.

The government has responded. The response of the Treasury Board Secretariat on behalf of the government is included at the end of the chapter. The government welcomes the ideas in the chapter as consistent with recent government initiatives. It stresses the need to tailor the application of any principles to individual circumstances. The government welcomes the opportunity to continue the dialogue on accountability.

Introduction

9.11 Though accountability is a critical element of representative democratic government, many Canadians believe their government is not held adequately to account.

9.12 Accountability is not a simple concept. What it means and how it is supposed to work are often disputed, so applying it effectively can be daunting. Moreover, how can a concept founded on historical principles of Westminster-style government administration apply today, amid the complexities of the modern public sector?

9.13 Today, Canadians are demanding clearer and greater accountability for the way the government spends their tax dollars and uses its authority. But the traditional view and practice of accountability are challenged in a public sector where the focus is on getting results, where the government engages in partnering arrangements with provinces and with outside organizations to deliver public policy, and where managers are encouraged to innovate and take reasonable risks.

9.14 Our Office has a long-standing interest in accountability, and many of our audits have examined it in practice. In 1996, we did a study of accountability practices and First Nations. In 1999 and again in 2002, we examined the mechanisms for accountability in new arrangements set up to deliver federal public policy (see Office of the Auditor General of Canada: April 2002 Report, Chapter 1; 1999 Report, Chapters 5 and 23; and 1996 Report, Chapter 13). Several years ago, with the Treasury Board Secretariat we published a joint discussion paper on accountability that introduced many of the ideas discussed in this chapter (see Office of the Auditor General and the Treasury Board Secretariat, *Modernizing Accountability Practices in the Public Sector*, January 1998).

Focus of the study

9.15 The objectives of this study are to propose and discuss an enhanced concept of accountability, consistent with and supportive of the realities of today's public sector. We also explore Parliament's role in furthering effective accountability for public management. Our intent is to promote discussion and clarity on ways to make accountability practices more effective in today's public sector.

9.16 Public service reforms have raised questions about the principle of ministerial accountability. Yet it remains the cornerstone of our democratic parliamentary system. This chapter does not address the debate over ministerial accountability, but instead examines accountability in the management and delivery of government programs.

9.17 Further details on the study are discussed at the end of the chapter in the section About the Study. Previous work published by this Office and cited in the chapter can be found on our Web site at http://www.oag-bvg.gc.ca.

Observations

Accountability and the new public management

9.18 In our democratic system, the people elect the government and the government must be held to account, in Parliament, for the way it uses public authority. Ministers are individually accountable to Parliament for their own actions and for all aspects of their departments' and agencies' activities. Ministers are also collectively accountable for the decisions taken by the Cabinet.

9.19 Officials are accountable to their ministers for the operation of their organizations, and not to Parliament. Traditionally, they remain anonymous. They may be required to explain those operations to Parliament on behalf of their ministers, but they do not answer to Parliament for government policy.

9.20 In our view, accountability within our Westminster-style government administration can serve three purposes:

- to control against the abuse or misuse of power;
- to provide assurance that activities were carried out as intended and with due regard for fairness, propriety, and good stewardship; and
- to encourage improved performance of programs and policies, through reporting on and learning from what works and what does not.

9.21 Public sector management and governance are changing, becoming more complex and creating new pressures on traditional notions of accountability. Three developments in particular make this clear: the focus on results, and especially on outcomes; the use of partnering arrangements to deliver programs and services; and the provision to managers of public programs (both public servants and their partners) of more flexibility and discretionary authority to innovate.

Focus on results

9.22 Managers of public programs today are asked to focus on the results they accomplish, that is, the outputs of their activities and the outcomes that result. The government first asserted its support for this focus in 1995, and in 2000 reiterated its commitment in *Results for Canadians: A Management Framework for the Government of Canada*.

9.23 Traditionally, accountability primarily has meant accounting for inputs, for adherence to detailed rules and procedures, and for actions taken. If things go wrong, those in charge can be held to account for what they control. Yet the outcomes sought for most programs are not entirely controllable. Outcomes are influenced by a number of outside factors, including social and economic trends as well as other programs at the federal, provincial, and municipal levels. For what, then, can ministers and program managers be reasonably held to account?

Delivery through partnering

9.24 Today, the federal government increasingly delivers federal public objectives through non-hierarchic relationships, such as networks and partnering arrangements with provincial and territorial governments and the private and voluntary sectors. These arrangements have often resulted in new and complex accountability relationships.

9.25 In these forms of delivery, the arrangements are often among "equals" or independent organizations and involve no hierarchic relationship. Instead, there is some form of shared accountability. A similar situation arises when individuals in a network collaborate and are accountable to their individual superiors or a collectivity of their superiors for their contribution to a product. What is shared accountability? And how can it be shared by equal or independent partners?

Increased discretion, flexibility, and innovation

9.26 Modern public management seeks to provide managers of public programs with more discretion in the use of authority and with reasonable flexibility to make informed decisions about the resources and inputs they use, the outputs they produce, and the ways they produce them. In some cases, increased flexibility is provided in exchange for greater accountability. Managers are to take well-considered risks in order to innovate. They are to learn from what works and what does not. However, a move to greater discretion, flexibility, and innovation is not supported by accountability that focusses solely on complying with too many and unneeded rules and procedures. How can accountability accommodate the risks that come with an innovative and flexible public sector?

9.27 After introducing and discussing an enhanced definition of accountability, we return to address these questions.

Accountability enhanced

9.28 With the Treasury Board Secretariat, several years ago we suggested a definition of accountability that retained the essential elements of traditional accountability but responded to today's pressures on it. For this chapter, we have further refined that definition:

> Accountability is a relationship based on obligations to demonstrate, review, and take responsibility for performance, both the results achieved in light of agreed expectations and the means used.

9.29 This definition encompasses a number of ideas (Exhibit 9.1) and is meant to apply to a wide range of accountability relationships: between ministers and deputy ministers, between departments and central agencies, between public servants in a hierarchic relationship, between parties in a partnering arrangement, and between the federal government and Parliament. Each of these relationships is unique and has its own level of formality and complexity.

9.30 Our definition of accountability offers several enhancements to traditional accountability:

- **Accountability among partners.** Our definition allows for a shared accountability relationship among partners who might be equal and/or independent, so it need not be used only in hierarchic relationships.

- **Reciprocal accountability.** It stresses that there are obligations on all parties in an accountability relationship, not merely on a subordinate party, as the traditional concept implied.
- **Importance of both ends and means.** Parties are accountable not just for results but also for the way they achieve the results.
- **Need for review and adjustment.** Accountability includes not just reporting on performance, but also making use of and reflecting on that performance in order to make appropriate changes or improvements and bringing appropriate consequences to bear on individuals, whether rewards or sanctions.

Exhibit 9.1 The elements of accountability

[illegible]

A relationship	Accountability involves two (or more) parties in a relationship that features certain obligations.
Obligations	All parties in an accountability relationship have obligations that imply responsibilities and consequences. In addition to the obligations inherent in the relationship (to demonstrate, review, and take responsibility), others can come from outside (such as legal, professional, contractual, and hierarchic obligations) and from an internalized sense of integrity.
Demonstrate	Demonstrating performance involves proactively reporting what results have been achieved and the appropriateness of the means used. It requires honesty, openness, and transparency. In a hierarchic relationship, this obligation is on the subordinate party.
Review	Review involves analyzing and reflecting on the reported results and the means used, and then taking appropriate action. Each party has an obligation to review. Those accounting should review to learn what is working and what is not, and should adjust their activities accordingly. Those holding to account should direct or call for any needed change. If performance is good, this could simply mean reconfirming current activities or could entail individual rewards. If performance is weak, corrective action would be expected. Review and adjustment of unacceptable performance might involve sanctions on individuals. Review can also result in revising expectations or adjusting other elements of the accountability relationship.
Take responsibility	Taking responsibility emphasizes answering for and accepting responsibility for what has or has not been accomplished and for the means used in the effort.
Results	A key focus in accountability is on the results (outputs and outcomes) accomplished or not accomplished.
Agreed expectations	The agreed expectations stem from either a formal or informal agreement on what is to be accomplished. In a hierarchic situation, one would expect a degree of discussion between the two parties as to what is reasonable and feasible, placing an obligation on the superior party to be clear about what is expected.
In light of	This emphasizes that performance is comparative. One is called on to compare what was accomplished with what was expected. Effective accountability requires disclosure: setting out beforehand what is expected and then reporting against those expectations. It also requires learning: looking *in light of the expectations* at what was accomplished or not, and what has been learned that will improve future performance.
The means used	How one delivers public services, uses authority, and handles public money are more than means of achieving results: they are ends in themselves, important reflections of public sector values and ethics. It is expected that the means used treat people fairly, are undertaken with propriety, and reflect good stewardship—that is, provide best value for money and respect the environment.

Principles of effective accountability

9.31 Exhibit 9.2 sets out five principles of effective accountability that reflect practice [illegible] accountability. We suggest that the more [illegible] principles [illegible] relationship will be. However, [illegible] all. We [illegible] the importance [illegible] accountability [illegible].

Exhibit 9.2 Principles of effective accountability

Clear roles and responsibilities	The roles and responsibilities of the parties in the accountability relationship should be well understood and agreed upon.
Clear performance expectations	The objectives pursued, the accomplishments expected, and the operating constraints to be respected (including means used) should be explicit, understood, and agreed upon.
Balanced expectations and capacities	Performance expectations should be clearly linked to and balanced with each party's capacity (authorities, skills and resources) to deliver.
Credible reporting	Credible and timely information should be reported to demonstrate what has been achieved, whether the means used were appropriate, and what has been learned.
Reasonable review and adjustment	Fair and informed review and feedback on performance should be carried out by the parties, achievements and difficulties recognized, appropriate corrections made, and appropriate consequences for individuals carried out.

The light of transparency

9.32 Transparency is an important element of effective accountability. It implies that one can see clearly into the activities of government. There are some exceptions: some aspects of government operations are not subject to public scrutiny (such as privacy and confidences between employer and employee, third-party confidences, and advice to ministers and Cabinet). In the federal government, the Access to Information Act [illegible] transparency.

9.33 Members of Parliament have told us how important they consider transparency to be for effective accountability. Too often the public is left feeling that government does not provide clear information on performance that falls short of expectations. Members noted that greater transparency would be one way to increase the trust the public has in their political institutions.

9.34 Clear, timely information on how money was spent and what it achieved makes it easier for those outside government to monitor and challenge whether spending was proper and consistent with good stewardship. Furthermore, the knowledge that their actions and decisions are

- **Reciprocal accountability.** It stresses that there are obligations on all parties in an accountability relationship, not merely on a subordinate party (as the traditional concept implies)
- **Importance of both ends and means.** Parties are accountable not just for results but also for the way they achieve the results.
- **Need for review and adjustment.** Accountability includes not just reporting performance but also analyzing and reflecting on that performance, making appropriate changes to improve it, and bringing appropriate consequences to bear on individuals, whether rewards or sanctions.

Exhibit 9.1 The elements of accountability

Accountability is a relationship based on obligations to demonstrate, review, and take responsibility for performance, both the results achieved in light of agreed expectations and the means used.

A relationship	Accountability involves two (or more) parties in a relationship that features certain obligations.
Obligations	All parties in an accountability relationship have obligations that imply responsibilities and consequences. In addition to the obligations inherent in the relationship (to demonstrate, review, and take responsibility), others can come from outside (such as legal, professional, contractual, and hierarchic obligations) and from an internalized sense of integrity.
Demonstrate	Demonstrating performance involves proactively reporting what results have been achieved and the appropriateness of the means used; it requires honesty, openness, and transparency. In a hierarchic relationship, this obligation is on the subordinate party.
Review	Review involves analyzing and reflecting on the reported results and the means used, and then taking appropriate action. Each party has an obligation to review. Those accounting should review to learn what is working and what is not, and should adjust their activities accordingly. Those holding to account should direct or call for any needed change. If performance is good, this could simply mean reconfirming current activities or could entail individual rewards. If performance is weak, corrective action would be expected. Review and adjustment of unacceptable performance might involve sanctions on individuals. Review can also result in revising expectations or adjusting other elements of the accountability relationship.
Take responsibility	Taking responsibility emphasizes answering for and accepting responsibility for what has or has not been accomplished and for the means used in the effort.
Results	A key focus in accountability is on the results (outputs and outcomes) accomplished or not accomplished.
Agreed expectations	The agreed expectations stem from either a formal or informal agreement on what is to be accomplished. In a hierarchic situation, one would expect a degree of discussion between the two parties as to what is reasonable and feasible, placing an obligation on the superior party to be clear about what is expected.
In light of	This emphasizes that performance is comparative. One is called on to compare what was accomplished with what was expected. Effective accountability requires disclosure: setting out beforehand what is expected and then reporting against those expectations. It also requires learning: looking *in light of the expectations* at what was accomplished or not, and what has been learned that will improve future performance.
The means used	How one delivers public services, uses authority, and handles public money are more than means of achieving results: they are ends in themselves, important reflections of public sector values and ethics. It is expected that the means used treat people fairly, are undertaken with propriety, and reflect good stewardship—that is, provide best value for money and respect the environment.

Principles of effective accountability

9.31 Exhibit 9.2 sets out five principles of effective accountability. They reflect practices or characteristics most often associated with effective accountability. We suggest that the stronger the application of these principles in an accountability relationship, the more effective accountability will be. However, "one size does not fit all." While in all cases the principles are important, their practice needs to be tailored specifically to each accountability relationship.

Exhibit 9.2 Principles of effective accountability

Clear roles and responsibilities	The roles and responsibilities of the parties in the accountability relationship should be well understood and agreed upon.
Clear performance expectations	The objectives pursued, the accomplishments expected, and the operating constraints to be respected (including means used) should be explicit, understood, and agreed upon.
Balanced expectations and capacities	Performance expectations should be clearly linked to and balanced with each party's capacity (authorities, skills, and resources) to deliver.
Credible reporting	Credible and timely information should be reported to demonstrate what has been achieved, whether the means used were appropriate, and what has been learned.
Reasonable review and adjustment	Fair and informed review and feedback on performance should be carried out by the parties, achievements and difficulties recognized, appropriate corrections made, and appropriate consequences for individuals carried out.

The light of transparency

9.32 Transparency is a sustaining element of effective accountability. It implies that one can see clearly into the activities of government. There are some exceptions: some aspects of accountability arrangements are closed to public scrutiny (such as privacy and confidentiality between employee and employer, third-party confidences, and advice to ministers and Cabinet). In the federal government, the *Access to Information Act* sets the ground rules for transparency.

9.33 Members of Parliament have told us how important they consider transparency to be for effective accountability. They and the public often feel that government does not provide enough information on performance that falls short of expectations. Members have said that greater transparency would be one way to increase the trust Canadians have in their political institutions.

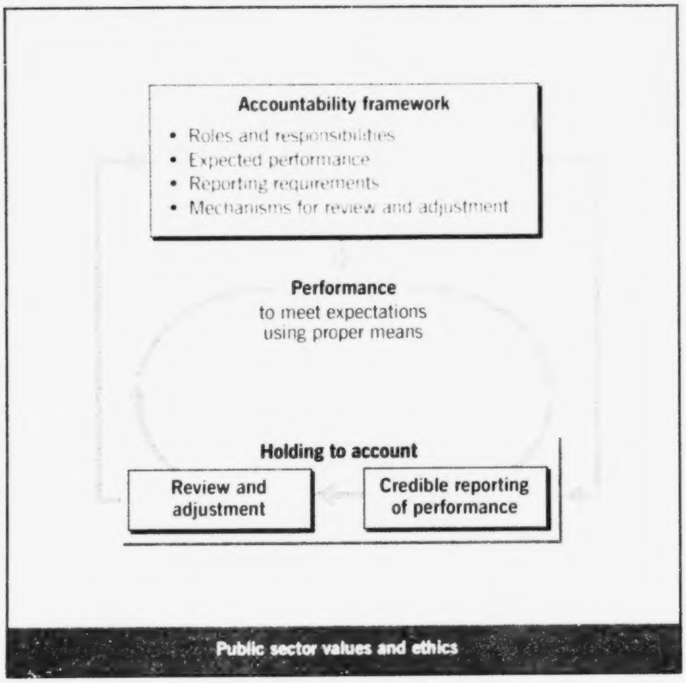
9.34 Clear, timely information on how money was spent and what it achieved makes it easier for those outside government to monitor and challenge whether spending was fair, proper, and consistent with good stewardship. Furthermore, the knowledge that their actions and decisions are visible encourages ministers and managers of public programs to behave in ways that can withstand public scrutiny. Overall, transparency and accountability mean stronger institutions and more credible government.

The accountability process

9.35 Exhibit 9.3 illustrates an accountability process based on the principles of effective accountability. In applying these principles, two aspects of the accountability process need to be considered:

- **The accountability framework.** Is there an appropriate accountability framework in place to support strong accountability relationships?
- **Holding to account.** Are effective reporting, review, and adjustment occurring?

Exhibit 9.3 The accountability process


Accountability framework
• Roles and responsibilities
• Expected performance
• Reporting requirements
• Mechanisms for review and adjustment
Performance
to meet expectations
using proper means
Holding to account
Review and adjustment
Credible reporting of performance
Public sector values and ethics

9.36 Public sector values and ethics, such as fairness, honesty, probity, integrity, and fidelity to the public trust, underlie any accountability process. Without a shared understanding of these basic values by the parties involved, an accountability process is unlikely to be effective. Public sector managers and their partners who deliver public services for the government should actively promote and enforce a corporate culture of high ethical standards and public sector values. The more those delivering public functions have internalized a sense of responsibility for observing public sector values and ethics, the less those values and ethics need to be formalized in accountability arrangements.

An accountability framework

9.37 An appropriate accountability framework is an essential beginning for effective accountability. Its importance is often reflected in documents that outline specific arrangements for accountability. Documenting these arrangements helps ensure a robust accountability relationship, one that sets out a basis for assessment and that does not change if individuals in the arrangement are changed. As shown in Exhibit 9.3, a good accountability framework has four elements, which are based on the principles of effective accountability.

9.38 **Roles and responsibilities**. There is a need for a clear understanding of the roles and responsibilities—the duties, obligations, and related authorities—of parties in an accountability relationship. Responsibility can be delegated from superior to subordinate or, in a partnering relationship, delegated to a partner or assumed by the partner by mutual agreement. Arriving at this understanding includes setting out clearly what specific activities and tasks are expected of each party and how the relationship is to be managed. Some collaborative arrangements are managed and even delivered jointly by the partners. In those cases, the clarification of roles and responsibilities could focus on how the arrangement will be managed rather than what role each partner will play. Without a clear understanding, the basic underpinnings of an effective relationship are absent. This risks confusion when the arrangement is implemented and, if things go wrong, makes it more difficult to find out why.

9.39 **Expected performance**. If expectations are unclear, accountability for performance is difficult to attain. Mutually understood and accepted expectations—including what each party is expected to contribute to the end result and what means are appropriate to use—will strengthen the accountability relationship. The operating constraints on the parties also need to be set out. Partners in the federal government have administrative rules and procedures to follow; if they have outside organizations as partners, the accountability framework needs to set out the basic operating principles and rules that are to be followed, including public sector values and ethics.

9.40 An accountability relationship that is effective has expectations that are realistic. The absence of a reasonable balance between what is expected and what authorities and resources are available to apply will tend to undermine the effectiveness of the relationship. Expectations that are seen as unreasonable or unachievable with available resources and capacity will not be taken seriously. At the same time, meeting expectations with resources that are more than adequate would not garner much credit; meeting expectations should require some stretching. Accordingly, accountability is enhanced by a balance among resources, authorities, and expected results.

9.41 **Reporting requirements.** The parties in an accountability relationship need to be clear about what information is to be reported by whom, to whom, and when. Being clear includes identifying the measurement strategy to be used, that is, how the required information is to be defined, collected, verified, and analyzed; by whom; and when.

9.42 **Mechanisms for review and adjustment.** Finally, clarity is needed on just how and by whom performance will be reviewed and adjustments made—how improvements will be made to performance and to the arrangement. The framework should lay out how the accountability process is to be completed.

9.43 The extent to which these components are formalized and consolidated in an accountability framework depends on the particular accountability relationship. For example, between superiors and their subordinates in the public service, roles, responsibilities, and expectations are often set out in work plans. The organization's personnel appraisal system stipulates when reporting is to take place and what the review and adjustment process will entail. Between ministers and Parliament, ministers' roles and responsibilities for the management of their programs are set out in the ministers' mandates. The performance expectations are set out in a variety of ways, such as in ministers' departmental Estimates and reports on plans and priorities, and their statements in Parliament. Reporting is accomplished through statements made and material tabled in the House by ministers, including their departmental performance reports. The review and adjustment mechanisms for ministers are the scrutiny carried out by Parliament in the House and Senate and the changes ministers make to programs and polices.

9.44 Exhibit 9.4 presents an example of an accountability framework where most elements are clearly spelled out in one document.

Holding to account

9.45 Key to accountability in practice is how those responsible are held to account. It is clear when accountability is not working well:

- there is no reporting or inadequate reporting on performance;
- there is no serious, informed review of the information reported; or
- there are neither appropriate program changes nor consequences for responsible individuals.

9.46 **Credible reporting.** Those responsible for delivering a public service or using public authority have a duty to report both the financial and the non-financial results they have achieved with the authority and public funds entrusted to them. In our view, they also have an obligation to report on the appropriateness of the means they used to achieve those results. This might entail reporting what assurance there is that the means used respected the pertinent aspects of fairness, propriety, and good stewardship. Their reports must be credible, understandable, and timely.

9.47 Here, candour is important—and in most organizations, it is a challenge. If reporting by public organizations is to be credible, it must be balanced—containing both good news and bad. Expectations are not always met, and sometimes for valid reasons.

Exhibit 9.4 A clear accountability framework: Infrastructure Canada

In our April 2002 Report, Chapter 1, Placing the Public's Money Beyond Parliament's Reach, we described the accountability framework of Infrastructure Canada, which had replaced the Canada Infrastructure Works Program. Infrastructure Canada is a collaborative arrangement between the federal government and provincial and territorial governments; its purpose is to improve urban and rural municipal infrastructure. A key difference between Infrastructure Canada and the earlier program is the governance and accountability framework. It sets out a clear accountability structure for the federal organizations involved in Infrastructure Canada and is a marked improvement over the situation in the program that preceded it.

Some elements of the governance and accountability framework are the following:

Roles and responsibilities. The framework outlines the roles and responsibilities of the Expanded Treasury Board; the Minister responsible for Infrastructure; the National Office of Infrastructure Canada; the ministers responsible for delivery; the Federal-Provincial/Territorial Management Committee and the Federal-Provincial/Territorial Co-Chairs; the provincial, territorial, and local governments; non-governmental organizations; the private sector; and federal departments.

Expected performance. The framework states that the ministers responsible for delivery will ensure that Parliament is informed of expected results through supplementary descriptive material included in each department's Estimates.

Reporting. The framework states that the Minister responsible for Infrastructure Canada will be responsible for reporting to Parliament on the program's overall objectives and results through the report on plans and priorities and the departmental performance report.

Review and adjustment. The framework states that the National Office will undertake program evaluations and other national reviews. It also states that the audit and evaluation frameworks will provide all the processes and controls necessary for due diligence to ensure proper spending of federal funds. Further review and adjustment take place when ministers report to Parliament.

In addition, the federal government has a program agreement with each of the provinces that outlines the roles and responsibilities of the management committee, the program's objectives and procedures, a Shared Information Management System for Infrastructure, and provisions for audit and evaluation of the program.

9.48 There are several ways for parties in an accountability arrangement to enhance the credibility of reporting:

- review and challenge both the stated expectations and the actual results reported;
- explain shortcomings in performance and show what has been learned as a result;
- disclose the basis on which a report has been prepared;
- ensure transparency—access to relevant information; and
- have external auditors provide assurance of the fairness and reliability of reported information.

9.49 **Review and adjustment.** Accountability involves taking responsibility for one's actions. Scrutiny and correction are required—review and analysis of performance and, based on that review, adjustments made to correct the

---

Exhibit 9.4 A clear accountability framework: Infrastructure Canada

In our April 2002 Report, Chapter 1, Placing the Public's Money Beyond Parliament's Reach, we described the accountability framework of Infrastructure Canada, which had replaced the Canada Infrastructure Works Program. Infrastructure Canada is a collaborative arrangement between the federal government and provincial and territorial governments; its purpose is to improve urban and rural municipal infrastructure. A key difference between Infrastructure Canada and the earlier program is the governance and accountability framework. It sets out a clear accountability structure for the federal organizations involved in Infrastructure Canada and is a marked improvement over the situation in the program that preceded it.

Some elements of the governance and accountability framework are the following:

Roles and responsibilities. The framework outlines the roles and responsibilities of the Expanded Treasury Board; the Minister responsible for Infrastructure; the National Office of Infrastructure Canada; the ministers responsible for delivery; the Federal-Provincial-Territorial Management Committee and the Federal-Provincial-Territorial Co-Chairs; the provincial, territorial, and local governments; non-governmental organizations; the private sector; and federal departments.

Expected performance. The framework states that the ministers responsible for delivery will ensure that Parliament is informed of expected results through supplementary descriptive material included in each department's Estimates.

Reporting. The framework states that the Minister responsible for Infrastructure Canada will be responsible for reporting to Parliament on the program's overall objectives and results through the report on plans and priorities and the departmental performance report.

Review and adjustment. The framework states that the National Office will undertake program evaluations and other national reviews. It also states that the audit and evaluation frameworks will provide all the processes and controls necessary for due diligence to ensure proper spending of federal funds. Further review and adjustment take place when ministers report to Parliament.

In addition, the federal government has a program agreement with each of the provinces that outlines the roles and responsibilities of the management committee, the program's objectives and procedures, a Shared Information Management System for Infrastructure, and provisions for audit and evaluation of the program.

9.48 There are several ways for parties to an accountability arrangement to enhance the credibility of reports:

- review and challenge both the stated expectations and the actual results reported;
- explain shortcomings in performance and show what has been learned as a result;
- disclose the basis on which a report has been prepared;
- ensure transparency—access to relevant information; and
- have external auditors provide assurance of the fairness and reliability of reported information.

9.49 **Review and adjustment.** Accountability involves taking responsibility for one's actions. Scrutiny and corrections are required—review and analysis of performance and, based on that review, adjustments made to correct the

[illegible]

9.50 [illegible]

9.51 [illegible]

9.52 [illegible]

Exhibit 9.5 **Streamlining First Nations reporting to federal organizations**

Our study of First Nations federal reporting (Chapter 1 of this Report) found that the requirements to report to federal organizations are a significant burden on First Nations. We estimated that 168 reports (for major programs) are required annually by the four largest federal organizations providing support to Aboriginal peoples. There is overlap and duplication among the required reports and little use is being made of them, either by federal organizations or by First Nations. We found inadequate reporting on performance, little review of the information reported, and few consequences of the reporting through learning or adjustment. In such instances, reporting does not serve accountability relationships adequately.

Accountability for performance: Results and means

9.53 How do we deal with the fact that the outcomes sought are not under the full control of the ministers and managers [illegible] People in the public sector [illegible] outcomes when their contribution [illegible] found it far more accept[illegible] outputs.

9.54 We suggest that [illegible] responsible [illegible] influence the achievement [illegible] accountability for results [illegible] difference [illegible] desired outcomes [illegible] influence [illegible]

Exhibit 9.6 **Accountability for performance: Results and means**

Accountability in a performance-based public service requires being able to credibly demonstrate:

- the extent to which the expected results were achieved;
- the contribution made by activities and outputs of the program to the outcomes;
- the learning and change that have resulted; and
- the soundness and propriety of the means used.

9.55 [illegible] still has to demonstrate [illegible] sound and proper [illegible] essential element [illegible] when risks were taken [illegible] And it [illegible] that activities [illegible] carried out with due regard [illegible] propriety and good stewardship. As stated in A Strong Foundation: Report of the Task Force on Public Service Values and Ethics:

> Both ministers and public servants must accept the personal consequences [illegible] when some problem has occurred because they acted improperly [illegible] not appropriately.

9.56 **Setting results expectations.** We have noted that an important aspect of accountability is knowing what level of performance is expected. Without this, accountability for performance is not possible. Equally important in a results-focused public sector is agreeing on how the outputs produced are expected to lead to the desired outcomes. In many cases, agreeing at the outset on clear and concrete expectations and their links to the program's activities can be even more difficult than subsequently measuring results (see our 2000 Report, Chapter 19, Reporting Performance to Parliament).

9.57 There are a number of reasons for the difficulty. For example, just how program interventions make a difference is not always well known, and actual outcomes may depend on factors outside the program manager's control. But with effort, discussion among the parties, and experience, the difficulty can be course when necessary. There is a role for sanctions on individuals, including the assigning of blame, when actions have been unreasonably risky or have violated basic norms of fairness, propriety, or good stewardship. A focus on results and innovation is not a licence for ignoring basic principles; for illegal, unethical, or otherwise improper behaviour; or for incompetence.

9.50 Those responsible for reviewing performance need to consider what results have been accomplished in light of expectations and of circumstances—including unanticipated contingencies—and then recognize achievement as well as underachievement and failure. In doing so, they too can learn. Review should be reasonable and fair and aimed at identifying ways to improve future performance as well as possible rewards or sanctions for individuals. Where program expectations clearly have not been met, there may be a need to adjust the accountability arrangement and note lessons learned. Performance can be reviewed within the organization or program, by an oversight authority in a partnering arrangement, by a minister, or by a parliamentary committee considering departmental performance reports.

9.51 Closing the accountability loop through review and adjustment can be an encouragement for all those involved to learn how to improve performance, particularly when the expected results have not been achieved. Good reporting should highlight where lessons have been learned and the delivery or design of programs altered. Those holding to account need to be particularly critical when expectations have not been met and when there is no evidence or inadequate evidence that improvements have been made.

9.52 Finally, it should be recognized that while effective accountability is not without cost, ineffective accountability can cost even more in waste, misuse of power, and loss of the government's legitimacy in the eyes of the governed. Establishing accountability frameworks, measuring and reporting results, reviewing performance, and making needed changes all require time, effort, and resources. These are the costs of a robust democracy. Nevertheless, accountability regimes should be tailored to specific circumstances. There is a need to avoid creating accountability frameworks and reporting regimes that are unnecessarily complex. For example, Exhibit 9.5 describes the complex requirements for reporting by First Nations to federal organizations.

Exhibit 9.5 Streamlining First Nations reporting to federal organizations

Our study of First Nations federal reporting (Chapter 1 of this Report) found that the requirements to report to federal organizations are a significant burden on First Nations. We estimated that 168 reports (for major programs) are required annually by the four largest federal organizations providing support to Aboriginal peoples. There is overlap and duplication among the required reports and little use is being made of them, either by federal organizations or by First Nations. We found inadequate reporting on performance, little review of the information reported, and few consequences of the reporting through learning or adjustment. In such instances, reporting does not serve accountability relationships adequately.

Accountability in today's public sector

Accountability for performance: Results and means

9.53 How do we deal with the fact that the outcomes sought are not under the full control of the ministers and managers responsible for a program? People in the public sector may be reluctant to accept accountability for outcomes when their control over achieving them is limited. Managers have found it far more acceptable to be held to account for inputs, activities, and outputs.

9.54 We suggest that holding to account for results asks if everything reasonable has been done with available authorities and resources to influence the achievement of expected results (see Exhibit 9.6). This kind of accounting for results means demonstrating in a reasonable fashion that a difference has been made, that actions and efforts have contributed toward desired outcomes. It means accounting for the outcomes that can be influenced as well as for the outputs produced or delivered.

Exhibit 9.6 Accountability for performance: Results and means

Accountability in a performance-based public service requires being able to credibly demonstrate

- the extent to which the expected results were achieved;
- the contribution made by activities and outputs of the program to the outcomes;
- the learning and change that have resulted; and
- the soundness and propriety of the means used.

9.55 Seen from this perspective, accountability still has responsibility for sound and proper action as an essential element. This means showing that when risks were taken, they were reasonable. And it means demonstrating that activities undertaken were carried out with due regard for fairness, propriety, and good stewardship. As stated in *A Strong Foundation*, The 1996 Report of the Task Force on Public Service Values and Ethics:

> Both ministers and officials must accept the personal consequences when some problem has occurred because they acted inappropriately or failed to act appropriately.

9.56 **Setting results expectations.** We have noted that if it is not clear in an accountability framework what level of performance is expected, effective accountability for performance is not possible. Equally important in a results-focussed public sector is agreeing on how the outputs produced are expected to lead to the desired outcomes. In many cases, agreeing at the outset on clear and concrete expectations and their links to the program's activities may be even more difficult than subsequently measuring results (see our 2000 Report Chapter 19, Reporting Performance to Parliament).

9.57 There are a number of reasons for the difficulty—for example, just how program interventions make a difference is not always well known, and actual outcomes may depend on factors outside the program manager's control. But with effort, discussion among the parties, and experience, the difficulty can be overcome and clearer, more concrete expectations defined. A bigger challenge may be to eliminate the comfort of expectations that are stated in broad, general terms. Clear and concrete expectations, such as targets, make evident what the results have to be to meet the expectations—and provide a basis for assessment by others. Expectations that are vague are easier to report against and harder to be held accountable for.

9.58 Individual ministers, central agencies, and Cabinet have a role to play in requiring that those who deliver programs establish clear and concrete expectations, challenging those expectations, and demanding credible reporting against them. Parliament, too, has a key role to play in challenging the expectations set by government.

9.59 **Measuring outcomes and assessing attribution.** Accountability that emphasizes results will be practical only if the outcomes can indeed be measured in some way—and, even more critical, if the program's contribution to achieving the outcomes can be assessed credibly.

9.60 In our view, performance measurement in the public sector needs to be seen not as an exact science but as a sensible gathering of information that will provide a better understanding of what a program is accomplishing. What is critical is that the limitations on measurement are recognized and are clearly identified in reporting.

9.61 Further, we think the problem of attribution—assessing the contribution made toward an outcome in light of other factors, other programs, and unforeseen contingencies—can be addressed. There are several techniques for measuring what a program has contributed to outcomes. This Office has suggested previously that while contributions may not be precisely measurable in many cases, a combination of logic and empirical evidence can provide a reasonable basis for concluding to what extent a program has contributed to an outcome (see *Addressing Attribution Through Contribution Analysis: Using Performance Measures Sensibly*, Office of the Auditor General, June 1999).

Accountability in partnering arrangements

9.62 Partnering arrangements involve organizations or individuals working together toward shared objectives. Such arrangements can arise between federal and provincial government departments, between departments of the same government, between government departments and the private or voluntary sector, or within an organization when teams or task forces are collectively accountable. The partners are collectively responsible for the operation of the arrangement, and they share accountability for its success. If the roles and responsibilities of each are not clear, however, shared accountability can become accountability diffused.

9.63 In our view, partnering arrangements require more and not less accountability: each partner can have several accountability obligations (see Exhibit 9.7). First, the arrangement—especially if it is more formal—creates horizontal accountability obligations among the partners, as Exhibit 9.4 showed in the case of Infrastructure Canada. In addition, each partner retains vertical accountability obligations to its superior or to its governing body—Parliament, in the case of the federal government—for its exercise of responsibilities and authorities, for the resources it contributes to the arrangement, and for the results of its contribution. Last, the partners are collectively accountable to their joint co-ordinating body—often a committee of senior officials or ministers—for the success of the arrangement. In some arrangements among levels of government, this collective accountability is to the public.

9.64 The federal/provincial Social Union Framework Agreement calls for each level of government to report to its constituents on the results achieved through federal/provincial agreements. Similarly, the health care reports issued by the federal and provincial governments in September 2002 are the result of another agreement by First Ministers. In our view, these constitute a form of accountability to the public. There is an obligation to demonstrate performance; the governments or organizations involved expect interested members of the public to review the material and make their concerns and criticisms known directly or through their legislators; and in our democratic society, there are strong incentives for ministers to react to public concern and make adjustments. At the same time, of course, the federal ministers involved account directly to Parliament for the resources used and the results achieved by the arrangement.

Exhibit 9.7 Shared accountability

In partnering arrangements, there are at least three kinds of accountability relationships:

- accountability among the partners;
- accountability between each partner and its own governing body—in the case of the federal government, Parliament; and
- accountability to the arrangement's joint co-ordinating body, in many cases.

The last may involve accountability to the public when the federal and provincial governments jointly agree to report to the public.

In a federal/provincial collaborative arrangement, for example, accountability for the federal government means it must credibly demonstrate to Parliament in a timely manner

- the extent to which objectives of the collaborative arrangement and those of the federal government are being achieved;
- the fairness, propriety, and good stewardship of the federal actions and strategies;
- a reasonable assessment of the federal contribution to the achievements, namely, to what extent it has made a difference; and
- the learning achieved through the arrangement.

Furthermore, the federal partner is responsible for

- organizing and managing the relationships with its partners so that it can obtain necessary information, monitor results, and make (or require) adjustments as needed; and
- ensuring that risks taken were reasonable and that partners' capabilities were adequately taken into account.

[illegible]

9.64 [illegible]

Exhibit [illegible] Shared accountability

In partnering arrangements, there are at least three kinds of accountability relationships:

- accountability among the partners;
- accountability between each partner and its own governing body (in the case of the federal government, Parliament); and
- accountability to the arrangement's joint co-ordinating body, in many cases.

The last may involve accountability to the public when the federal and provincial governments jointly agree to report to the public.

In a federal-provincial collaborative arrangement, for example, accountability for the federal government means it must credibly demonstrate to Parliament in a timely manner

- the extent to which objectives of the collaborative arrangement and those of the federal government are being achieved;
- the fairness, propriety, and good stewardship of the federal actions and strategies;
- a reasonable assessment of the federal contribution to the achievements, namely, to what extent it has made a difference; and
- the learning achieved through the arrangement.

Furthermore, the federal partner is responsible for

- organizing and managing the relationships with its partners so that it can obtain necessary information, monitor results, and make (or require) adjustments as needed; and
- ensuring that risks taken were reasonable and that partners' capabilities were adequately taken into account.

Accountability with increased discretion and flexibility: A learning public service

9.65 Managing for results includes learning what works and what does not, in order to modify and continually improve programs and services. It requires appropriate discretion, authority, and flexibility for managers who must take reasonable risks to innovate. Even when the risks taken are reasonable, some decisions can prove to be mistakes—even informed decisions. The key questions are whether risks were managed effectively and whether appropriate changes are being made as a result—what has been learned? And mistakes that were the result of carelessness, incompetence, or malfeasance call for appropriate sanctions.

9.66 Our enhanced concept of accountability supports managing for results and hence a culture of learning. It asks ministers and managers to demonstrate credibly that they are learning (from mistakes as well as successes), taking corrective action where appropriate, and following up on weaknesses, rather than focussing only on who is at fault when things go wrong. This will develop confidence that managers of public programs can use their greater discretion responsibly.

9.67 When expectations are not met, a natural tendency is to assign blame. A learning public service instead accepts responsibility, acknowledges mistakes, and assesses the cause. It learns from "bad" decisions to avoid repeating them. A learning public service would visibly reward learning and would focus on blame only if incompetence, imprudence, or malfeasance were at issue. In his 2000 Report, Matters of Special Significance, the Auditor General said:

> Accountability requires that people accept responsibility for their mistakes—that goes without saying. Excessive emphasis on laying blame, however, can be counterproductive. If we wish to empower employees and encourage them to innovate, then we must be prepared to accept the risk that, at times, mistakes and wrong decisions will be made. When that happens, we should focus on learning from the experience rather than assigning blame.

9.68 In order to innovate, take reasonable risks, and learn from mistakes, managers need a degree of discretion and flexibility to act. However, accountability for too many or unneeded rules and procedures can impede innovation and lead to inefficiency, ineffectiveness, and frustration. Certain rules and regulations, laws, and guidelines—a basic set of controls—are indispensable to sound administration and accountability. In our view, basic administrative rules should be few, easily understandable, and consistently applied.

9.69 In the federal government, it is ministers who most often have to explain and defend the decisions of managers. Solid evidence of what has been learned from mistakes would help in this defence, but it is clear that ministers will have a key role in defining tolerance for risk because it is they who are ultimately accountable to Parliament.

Strengthening Parliament's role

9.70 Parliament has a key role in calling government ministers to account in the House, in the Senate, and in committees. Learning and sensible risk-taking are not likely to flourish if acknowledged mistakes are used in a politically charged way; full reporting is then unlikely—incomplete reporting is safe reporting. Yet Parliament's role is to hold the federal government to account for its use of authority and to scrutinize what Canadians get for their tax dollars. We must expect that scrutiny will often be adversarial.

9.71 Parliament has a significant role to play in ensuring accountability for results in a performance-based public service. To that end, Parliament, particularly the House,

- scrutinizes the performance expectations set out in the government's plans and priorities documents; and
- reviews the performance reports presented by government.

Both of these activities could be strengthened.

9.72 **A need to scrutinize performance expectations.** The report on plans and priorities tabled for each federal department in the spring sets out plans and the expected results for three years ahead. These Estimates documents describe what each minister intends to provide to Canadians for their tax dollars. The plans are an explicit part of the accountability relationship between Parliament and the government. Review and approval do take place but usually without much discussion.

9.73 The government should be challenged to provide clear plans and priorities. If parliamentary scrutiny of plans and priorities documents is lacking or is merely cursory—for example, if the documents are simply deemed to have been approved—the government may be less likely to be clear and specific about its planning commitments. Greater clarity promotes better parliamentary and public understanding of government intentions and assists in holding the government to account for its performance against its plans.

9.74 **A need to scrutinize performance.** Every fall since 1997, the government tables a performance report by each department that describes what has been accomplished against previously stated expectations. To date, the quality of these reports has been mixed and their scrutiny by Parliament is limited. The lack of review impedes the closing of the accountability loop—the holding of government to account for its performance.

9.75 In *Parliamentary Committee Review of the Revised Estimates Documents* our Office suggested in 1998 how such review by parliamentary committees might be approached (we are updating and reissuing the document). Key questions committees could consider with the plans and the performance reports include the following:

- Are the objectives and the costs of the program reasonable and clearly described?
- Has the program delivered the planned benefits to Canadians?

- Has the program's contribution to the results achieved been well explained?
- Could the program be delivered more efficiently?
- Could the benefits be delivered in a more cost-effective manner?
- Are the documents useful for the committee's policy and legislative agenda?

Furthermore, committees could ask what has been learned and what is going to be done differently as a result.

9.76 Unfortunately, most members of Parliament have little incentive to devote their limited committee time to this kind of review when many feel it will not change or influence the government's agenda. They and many observers have commented on the need to strengthen committee scrutiny of the government's performance. We agree. The House of Commons recently created the Government Operations and Estimates Committee, whose mandate allows for examining the effectiveness of the Estimates scrutiny process. This committee may help address some of these concerns.

Conclusion

9.77 In our view, the vision of accountability we propose addresses the pressures on traditional accountability in today's public sector. It is consistent with and supports

- a focus on results, including outcomes;
- shared accountability in partnering arrangements; and
- reasonable risk-taking and a learning public service.

9.78 This chapter suggests that accountability should be seen less as a process for assigning blame and more as a process for

- agreeing on performance expectations;
- demonstrating results achieved and the appropriateness of the means used to achieve them in a credible, transparent, and proactive way, and taking responsibility for them;
- reviewing performance through supportive assessment and feedback aimed at creating a continuous learning environment; and
- ensuring timely corrective action for the program and consequences for individuals as necessary.

9.79 The importance of public sector values—fairness, propriety, and good stewardship—in the means used to achieve results must not be neglected. While identifying those responsible for serious mistakes is still important, the emphasis needs to shift to assessing the results and the learning achieved. Our enhanced concept of accountability supports the learning based on results that is essential to managing in an innovative public sector.

9.80 This chapter has presented ideas and approaches for considering accountability in a wide range of accountability relationships. Some of the past work of this Office has used these ideas to examine specific cases, such as collaborative and delegated arrangements. Determining how accountability mechanisms should be tailored to specific relationships will be an ongoing effort. We hope these concepts, suitably tailored, will help others build effective accountability relationships.

9.81 Enhanced accountability should lead to a clearer understanding of what the government does and achieves, and should encourage ministers and managers of public programs to focus on the results being achieved and the means used to achieve them.

The Treasury Board Secretariat's response on behalf of the government. The issues involved in accountability go to the heart of *Results for Canadians*, the government's management framework. Under this framework, the government recognizes that a citizen focus must shape the management of its programs and services. It commits to manage by a clear set of public service values and to focus on results and responsible spending. The ideas presented in the chapter are supportive of these commitments and are consistent with recent government initiatives to strengthen results-based management and accountability.

The government welcomes the effort to define elements and principles of effective accountability as summarized in exhibits 9.1 and 9.2 of this chapter, respectively. Given a complex and always changing mix of collaborative arrangements between diverse government entities and those of the private, public, and not-for-profit sectors, such principles must be cast—of necessity—in broad or generic terms. As the chapter indicates, the application of any generic principles must be well tailored to the individual circumstances at hand.

In particular, levels of documentation on accountability must be reasonable in light of the collaborative relationships involved. Potential administrative burdens must be considered. Accountability arrangements may need to be cast flexibly to allow for uncertainty or changing relationships. And informal accountability arrangements, as well as formal ones, can often meet the test of sound management practice. These practical considerations may well call for a sixth basic principle of effective accountability—that the arrangements put in place must be appropriate, reasonable, and workable given the circumstances at hand.

The government welcomes this chapter and the opportunity it provides to continue and strengthen the dialogue around accountability. That dialogue should contribute to advancing a management culture that supports transparency, learning, and innovation, as well as the constructive engagement of parliamentarians and Canadians in the improvement of government programs over time.

About the Study

Objectives

The objectives of the study were

- to propose and discuss an enhanced concept of accountability consistent with the realities of today's results-focussed, partnering, and innovating public sector, and
- to explore Parliament's role in furthering effective accountability.

We hope to encourage discussion and contribute to greater clarity on appropriate accountability in today's public sector.

Scope and approach

The study addressed the concept of accountability and how it can be enhanced in modern public management. We did not examine issues of ministerial accountability in our parliamentary system. While the principle of ministerial accountability has been tested by elements of public service reform, it remains the cornerstone of our democratic parliamentary system. It is within this tradition that the study was set. We examined accountability as it applies to ministers and officials responsible for the management and delivery of government programs.

Approach

The study was based on previous work by our Office on accountability, discussions with knowledgeable individuals and a number of members of Parliament, and a review of relevant literature.

Study team

Assistant Auditor General: Maria Barrados
Principal: John Mayne
Director: Robert Cook
Auditor: Alex Smith

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Report of the Auditor General of Canada to the House of Commons—December 2002

Main Table of Contents

Matters of Special Importance—2002
Foreword and Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada-Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada-Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

Appendices

2002

Report of the
Auditor General of Canada
to the House of Commons

DECEMBER

Chapter 10
Department of Justice—Costs of Implementing the Canadian Firearms Program

Office of the Auditor General of Canada

The December 2002 Report of the Auditor General of Canada comprises 11 chapters, Matters of Special Importance — 2002, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

Ce document est également disponible en français.

© Minister of Public Works and Government Services Canada 2002
Cat. No. FA1-2002/2-18E
ISBN 0-662-33116-8

Chapter

10

Department of Justice

Costs of Implementing the Canadian Firearms Program

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

Table of Contents

Main Points 1

Introduction 3

Current ownership and registration requirements are more rigorous 3
Federal and provincial governments were expected to share responsibilities 4
Focus of the audit 5

Observations 5

Obstacles to accountability 5

Single point accountability for the Program was not implemented 5
Program cost estimates have risen from $119 million to over $1 billion 6
Contrary to the original announcement, fees will not cover expenditures 7
From the start insufficient financial information was provided to Parliament 7
Supplementary estimates were inappropriately used 8
Accountability for all Program costs was not maintained 9
The financial information provided does not fairly present all costs 10

History of cost escalation 11

In 1996 the Department recognized that funding assumptions were unrealistic 11
In May 1998, program costs were estimated to be $544 million 12
By February 2000, program cost estimates had increased to $764 million 12
By May 2000, the Program cost estimates rose to more than $1 billion 13
In February 2001, a new plan to restructure the Program was approved 14
The program became excessively regulatory 14
Restructuring involves replacing an expensive, three-year-old computer system 15
Some responsibilities are being moved to the Department of Justice 16
Failure to follow Treasury Board's approval processes contributed to problems 17
Poor management contributed to the escalation of costs 17
There were deficiencies in the management of revenues and refunds 18

Conclusion and Recommendation 18

About the Audit 21

Department of Justice
Costs of Implementing the Canadian Firearms Program

Main Points

10.1 The Department of Justice Canada did not provide Parliament with sufficient information to allow it to effectively scrutinize the Canadian Firearms Program and ensure accountability. It provided insufficient financial information and explanations for the dramatic increase in the cost of the Program.

10.2 In 1995 the Department told Parliament that the Canadian Firearms Program would cost $119 million to implement, which would be offset by $117 million in fees. We requested the Department provide us with information on Program costs and revenues for the period 1995–96 to 2001–02. The information the Department provided states that by 2001–02 it has spent about $688 million on the Program and collected about $59 million in revenues after refunds. We believe that this information does not fairly present the cost of the Program to the government.

10.3 In 2000, the Department of Justice estimated that by 2004–05 it would spend at least $1 billion on the Program and collect $140 million in fees after refunds. This amount does not include all financial impacts on the government. The Department also did not report to Parliament on the wider costs of the Program as required by the government's regulatory policy.

10.4 The Department has offered many reasons for the cost escalation, including major delays in making regulations, provinces opting out of the Program, the need for additional initiatives, incorrect assumptions about the rate it would receive applications for licences and registrations, and an excessive focus on regulation and enforcing controls.

10.5 Complete and accurate financial information and explanations on Program costs and revenues should have been reported to Parliament annually in the Department's Report on Plans and Priorities and in its Departmental Performance Report. These formal documents are intended to provide information to Parliament in order to allow it to scrutinize departmental expenditures.

10.6 The Department of Justice should provide Parliament annually with complete and accurate information on all past, current, and forecasted expenditures and revenues relating to the Program; and it needs to disclose and explain any major changes in the Program.

Background and other observations

10.7 Under the 1995 *Firearms Act* the Department is responsible for the Canadian Firearms Program. This legislation requires that all owners and users of firearms be licensed by 1 January 2001 and that all firearms be registered by 1 January 2003. The federal government estimates that the total number of firearms owners is 2.46 million and the total number of firearms is 7.9 million.

Federal agencies have responded. Department of Justice Canada acknowledges that implementing this program across Canada was a significant logistical, technical, and management challenge. It states that in the interest of public safety, and in response to recommendations from the public and Parliament, changes were made to the initial program design that increased the design of the system and its cost.

The Treasury Board Secretariat notes that the Department of Justice faced significant challenges in implementing a program of this magnitude and originality. It also notes that it was always understood that original estimates would be revised in response to the demands of program implementation.

Introduction

10.8 The Department of Justice estimated that in 2001 there were about 2.46 million firearms owners and 7.9 million firearms in Canada. The Canadian Firearms Program focusses on controlling acquisition, possession, and ownership of firearms; regulating the availability of specific types of firearms; and deterring the misuse of firearms. The Program requires that all owners of firearms be licensed by 1 January 2001 and that all firearms be registered by 1 January 2003.

10.9 In December 1995, to establish the Canadian Firearms Program, Parliament passed the *Firearms Act* and associated *Criminal Code* amendments. The *Criminal Code* amendments came into force in January 1996 creating mandatory minimum prison sentences for firearms offences. The government announced that it would delay proclamation of the Act until January 1997 so that the Department could design, develop, and implement the information technology and service delivery systems needed to manage the licensing and registration program. The Department recognized that the Program presented significant challenges due to its political, technical and organizational complexities.

10.10 The Department told us that the proclamation of the *Firearms Act* was further postponed to December 1998 because of "broad and time-consuming consultations about the new regulations." This resulted in delays in making regulations needed to set fees, and establish specific requirements for licensing, storage and record-keeping. Regulations were finally adopted in March 1998 and officially came into force in December 1998.

10.11 The Department's 2002–03 *Report on Plans and Priorities* stated that the objectives of the Program are "to implement a practical approach to gun safety that works to keep firearms from those who should not have them while encouraging safe and responsible gun use by legitimate firearms owners."

Current ownership and registration requirements are more rigorous

10.12 Passed in 1995, the *Firearms Act* and associated amendments to the *Criminal Code* provide for

- licensing all firearms owners;
- registering and tracking all firearms and transfers of firearms;
- controlling the import and export of firearms;
- strengthening the offence and sentencing provisions of the *Criminal Code*, including mandatory minimum sentences for certain firearms offences; and
- prohibiting additional specific firearms.

10.13 Individuals who only wanted to keep their non-restricted firearms had to apply before 1 January 2001 for a "possession only" licence. They also had to pass a review to determine that it was safe to give them a licence. Those who want to acquire a firearm must pass the Canadian firearms safety test, apply for a "possession and acquisition" licence, and pass a review that includes notification of spouse or partner. Owners must register each firearm that they possess.

10.14 As required by previous firearms legislation, owners and businesses must properly transport and store their firearms in accordance with the applicable regulations. Under the 1995 legislation they must also notify the government of any change in address and transfers of firearms to other licensees.

Federal and provincial governments were expected to share responsibilities

10.15 The federal government envisioned that the Chief Firearms Officers appointed by provincial governments would screen applications for possession licences with the federal government reimbursing them for these costs. Chief Firearms Officers are responsible for ensuring that the issue of a licence does not jeopardize public safety.

10.16 The Registrar in the Royal Canadian Mounted Police (RCMP) is responsible for registering firearms, and establishing and maintaining the Canadian Firearms Registry. The RCMP are also responsible for maintaining the interface with its Canadian Police Information Centre and the Registry. Legislation currently before Parliament proposes to transfer the Registrar to the Department of Justice.

10.17 The RCMP and provincial and municipal police are responsible for enforcing specific provisions of the *Firearms Act*. The RCMP also acts as a provincial police force in certain jurisdictions. Correctional Service Canada and the National Parole Board must administer the sentences of offenders serving mandatory and longer sentences as a result of the new firearms legislation. In addition, provincial correctional agencies must handle firearms offences relating to the legislation.

10.18 The federal government expected existing federal-provincial cooperation on firearms control would continue under the *Firearms Act*. Provinces and territories supported the provisions of the new legislation that deterred crime, toughened sentences for firearms offences, and targeted weapons smuggling. However, several provinces believed that licensing all owners and registering all firearms was an unproven and ineffective means to reduce violent crime. They also believed that legislating these requirements was beyond the constitutional power of the federal government. In September of 1996, the Province of Alberta announced that it would challenge the constitutionality of provisions of the new law. Five provinces and two territories subsequently supported Alberta in this challenge. The Supreme Court upheld the constitutionality of the provisions of the *Firearms Act* in June 2000.

10.19 The *Firearms Act* permitted provinces to opt-out of administering the Program. Alberta, British Columbia, Manitoba, Newfoundland and Labrador, and Saskatchewan, opted out. As a result, the RCMP and the Department, as authorized by the *Firearms Act*, set up a federal administrative system in jurisdictions that opted-out and incurred the costs directly. As part of this system, the Minister of Justice appointed "federal" Chief Firearms Officers for provincial jurisdictions.

10.20 The Supreme Court's judgment noted that Aboriginal Canadians who are concerned that this law does not address their particular needs could bring their claims to Parliament or the courts in a separate case. Certain Aboriginal groups are challenging the legislation in court, based on self-government and treaty rights to hunt.

Focus of the audit

10.21 Parliamentarians and the public have expressed concerns to us about the cost of the Canadian Firearms Program. Consequently, our audit focussed on the expenditures and revenues of the Program and we asked the Department of Justice to prepare a statement of these expenditures and revenues for the Program. We did not audit Program efficiency or whether it is meeting its objectives. Our audit objectives were as follows:

- To assess whether the statement of financial information prepared by the Department on the Canadian Firearms Program presents fairly the expenditures and revenues of the Program for the period 1995–96 to 2001–02 on a basis consistent with the framework used by the Department to obtain Government approval of Program funds.
- To provide Parliament with information on the changing costs and scope of the Program since its inception.

10.22 More details appear in About the Audit at the end of the chapter.

Observations

Single point accountability for the Program was not implemented

10.23 The Department of Justice is responsible for the Canadian Firearms Program, including the Canadian Firearms Registration System project. In early 1996 the Department of Justice established a division called the Canadian Firearms Centre. The Department and the Treasury Board designated it the "single point of responsibility and accountability to implement the Canadian Firearms Program." The importance of this single point responsibility and accountability was emphasized in the 1997 Project Charter the Department provided to the Treasury Board Secretariat. The Charter stated the following:

> Given the scope and complexity of the Canadian Firearms Program and its projects, and the importance of delivering in accordance with approved time lines and budgetary allotments, it was critical that a single point of authority and accountability be established.
>
> The Canadian Firearms Centre provides this single point of accountability in order to manage and ensure that the

> government's objectives are achieved via the full implementation of the *Firearms Act*.

10.24 The Charter also stated that

> The Canadian Firearms Centre, in its lead role, must provide centralized management and co-ordination for the Canadian Firearm Program as a whole. In this central management role, the Canadian Firearms Centre must
>
> - facilitate and support management efforts of the partners;
> - establish, to the extent practical, standard management practices and procedures; and
> - be responsible for representing the overall program to external agencies such as the Treasury Board.

10.25 Furthermore, the Department told the Government in February 2001 that under the *Firearms Act* the Minister of Justice is politically and financially accountable for the administration of the Program. More recently, the Department's July 2002 Strategic Plan provided to the Treasury Board Secretariat stated that the Minister of Justice is responsible for the *Firearms Act*, is answerable to Parliament for any issues related to the Act, and is responsible for seeking Parliament's authority to spend public money for the purposes described in the Act.

10.26 The single point of responsibility and accountability concept was not implemented. The Centre reports only expenditures that it incurs or reimburses, and not the full costs to the government of the Program.

Program cost estimates have risen from $119 million to over $1 billion

10.27 In November 1994, prior to the introduction of the *Firearms Act*, the Department of Justice estimated that the net cost of the new Program would be about $2 million. It also estimated that it would take five years to implement. During this period, it said expenditures of about $119 million were expected to be offset by licensing and registration fees of approximately $117 million.

10.28 In May 2000 the Department told the House of Commons Standing Committee on Justice and Human Rights that it had spent at least $327 million on the Program. However, at about the same time the Department informed the Government that it estimated that the cost of development and implementation would be over $1 billion by 2004–05.

10.29 Further, in its Regulatory Impact Analysis Statements the Department of Justice did not provide Parliament with an estimate of all the major additional costs that would be incurred. This disclosure was required by the government's regulatory policy. The costs incurred by the provincial and territorial agencies in enforcing the legislation were not reported. In addition, costs that were incurred by firearms owners, firearms clubs, manufacturers, sellers, and importers and exporters of firearms, in their efforts to comply with the legislation were not reported.

Contrary to the original announcement, fees will not cover expenditures

10.30 One of the reasons why the cost to taxpayers has risen significantly is that revenues from fees that were intended to cover most of the Program's expenditures have fallen far short of original expectations.

10.31 The *Firearms Act* authorizes the Governor in Council to prescribe, by regulation, the fees charged for firearms licensing, registration, and other services. For example, in December 1998, regulations came into force that established fees for over 50 types of licensing, registration, and other transactions. The fees ranged from $10 to $1,250.

10.32 In April 1995 the Department told Parliament that the Program would be essentially self-financing through licensing and other fees. In reality, revenues were reduced through a series of fee reductions and refunds to owners of firearms. We note that the full effect of the fee reductions on keeping the Program self-financed was not disclosed to Parliament. Information on refunds is necessary because if these funds were retained they would have reduced Program costs. Program costs increased because the fees were refunded. For example, in 2000–01 the Department refunded about $2 million in fees, increasing Program costs by that amount.

10.33 The information on cost recovery provided to the Government changed as the Program developed. For example, at the start of the Program in 1994 the Government was told that the Program would be self-financing by 1999–2000. However, in 1996 the Department told the Government that it would take more than 10 years (from 1995–96 to 2005–06) for the Program to become self-financing.

10.34 In April 1998, the Department again revised its estimated break-even point. The Government was told that it would take until 2012–13 for revenues from fees to cover all costs associated with developing, implementing, and operating the Program since 1995–96. The revised break-even point was based on the assumptions that the Program would collect about $419 million in fees by 2002–03 and about $828 million by 2007–08.

From the start insufficient financial information was provided to Parliament

10.35 The Department of Justice did not provide sufficient information to Parliament to allow it to fully scrutinize the Program. The Department also provided inadequate information to Parliament on the escalating Program costs from the start of the Program.

10.36 For example, in 1994, the Department told the Government that Correctional Service Canada and the National Parole Board would also incur costs to implement the Program. These costs would result from expected increase in workload associated with longer mandatory sentences for firearms offences, and the Government earmarked $126 million to cover these costs. However, in April 1995, the Department of Justice did not tell Parliament that these costs could be incurred by Correctional Service Canada and the National Parole Board as part of the Program. If these additional costs had been reported, the original estimated expenditure for implementing the new

Program over five years would have totalled about $245 million before revenues instead of the reported $119 million.

10.37 Correctional Service Canada and the National Parole Board received $5 million and $2 million, respectively, of the $126 million allocated to them to cover their Program costs. The Government authorized the redirection of approximately $119 million of the original $126 million to the Department of Justice for the Program.

10.38 The Department has provided only piecemeal financial information to parliamentarians rather than complete, systematic, and authoritative information. For example, until 2002–03, the Department's annual reporting to Parliament on its plans and priorities and departmental performance contained little financial information on the Program. This most recent reporting continues to fall well short of the government's reporting principles. These annual reports are key sources of information that enable Parliament to scrutinize expenditures and performance.

10.39 Furthermore, the entire Program was designated as a Major Crown Project. Treasury Board policies require departments, at a minimum, to annually report the following types of information to Parliament:

- description of the program;
- leading and participating departments and agencies;
- total expenditures to date and planned expenditures for future years to the completion of the project;
- prime and major sub-contractors;
- major milestones; and
- progress reports and explanations of variances.

The Department has not fully reported this information.

Supplementary estimates were inappropriately used

10.40 Departments obtain funding through main annual appropriations from Parliament. If they need additional funds during a given year they request these through further appropriations called "supplementary estimates." Between 1995–96 and 2001–02, the Department obtained only about 30 percent of $730 million in funds for the Program through the main appropriations method; in comparison, it obtained 92 percent of funding for all of its other programs through the main appropriations. Little additional information was given to explain the need for major supplementary estimates for the Program other than the required brief one-line statement that identified that the funds were for the Program.

10.41 To enable Parliament to maintain control over the public purse, departments ask for approval of supplementary estimates only for unanticipated expenditures not approved by the Treasury Board in the normal business cycle or for those which cannot be estimated in advance. We note that it has been clear for some time that fees collected have not covered Program costs and that the Department should have told Parliament that this was the case rather than maintaining that cost recovery was feasible and continuing to use supplementary estimates.

Accountability for all Program costs was not maintained

10.42 In September 2001, we asked the Department to provide us information on expenditures and revenues for the Program since 1995–96, for audit purposes. We requested that this information be prepared on a basis consistent with the framework used by the Department to obtain the Government's approval of Program funds. We made this request because, in our view, it would allow for clear and consistent accountability to Parliament and the Government for the use of funds. Program management at the time of our audit was not aware of the approach previously used by the Department to obtain Government approval for funding. We provided this framework in October 2001 in response to the Department's request.

10.43 The approach that the Department had used to obtain the Government's approval for funding is called "activity based costing." This approach linked expenditures to particular activities, such as Program management, training, communication, and the Canadian Firearms Registry System. It also showed how much money was provided to the RCMP and to each Chief Firearms Officer for Program activities.

10.44 In 1996, the Department of Justice emphasized to the Government the usefulness of using an activity based costing framework. It told the Government that the financial implications of the Program were being analyzed through a detailed activity based costing exercise. It also assured the Government that it would prepare a detailed and accurate evaluation of the costs involved in setting up the Program once this analysis was completed.

10.45 In February 2000, the Department informed the Treasury Board Secretariat that it would continue to develop and implement a Program-wide "Activity Based Costing/Activity Based Management/Activity Based Budgeting" system. The Department made this statement in response to the Secretariat's requirements and departmental management's need for accurate costing and budgeting information. To achieve this goal, the Department told the Treasury Board Secretariat that in January 1999 it had established a team consisting of two consultants, one senior financial analyst, and four financial analysts. The Department issued contracts to develop and expand its activity based costing framework. Between 1998 and 2000 it spent over $560,000 on these contracts.

10.46 However, during our audit, the Department's Canadian Firearms Centre told us that it could not readily provide the Program cost information in a way that was consistent with the framework. This was because the approach "is not currently used by [the Centre's] management for reporting purposes and therefore is not readily available through its existing Financial Management System." Centre officials also said that they were searching their files and contacting former employees to find out whether clear definitions of the cost categories previously used were available.

10.47 In June 2002, after much discussion, the Department gave us what it called its "best and final" effort to prepare information on expenditures and revenues as we requested. The Department agrees that it had difficulties in providing information in a manner consistent with the approvals given by Government. However, it also stated that it saw "little merit" in doing this since it believes that the information was not useful for managing the Program.

The financial information provided does not fairly present all costs

10.48 In our view, the financial information provided for audit by the Department does not fairly present the cost of the Program to the government. Our initial review found significant shortcomings in the information the Department provided. Consequently we stopped our audit of this information that because we did not believe that a detailed audit would result in substantially different findings.

10.49 The shortcomings that we identified include the following:

- The Department provided information only on costs incurred by the Department's Canadian Firearms Centre, not the total cost of developing, implementing, and delivering the Program. The information provided by the Department indicated that between 1995–96 and 2001–02 about $688 million had been recorded in its accounts as spent on the Program.
- Potential significant costs were not included for services provided without charge by the Department and other federal government departments and agencies, including such items as all litigation costs relating to the constitutional court challenges, total accommodation costs, and full employee benefit costs.
- The Department did not provide the financial information in a framework that is consistent with that used to obtain Government approval of funding.
- The Department had major difficulties in distinguishing between expenditures for project implementation and ongoing operations. This problem particularly affected two of the largest categories of costs: communications activities and the development and implementation of computer systems supporting the Canadian Firearms Registration System. The amounts allocated to these areas in various official documents differ significantly from one another. For example, one document provided to us stated that for 1997–98 the cost of the Canadian Firearms Registration System was about $13.5 million. However, the document provided to us for audit purposes stated that this amount was about $20 million.
- The Department had not yet conducted audits of claims worth about $135 million made for reimbursement of Program expenditures by third parties such as the RCMP and provincial governments. These audits are the responsibility of the Department under agreements with such parties and would have provided assurance on whether the claims were

appropriate. Further, a preliminary departmental review of one province's claims indicated that the province was not able to locate supporting documentation for the amounts claimed and subsequently paid by the Department.

10.50 Additional reasons why we decided to stop our audit of the Department's expenditure and revenue information included the following:

- there have been major changes to the Departmental financial systems since 1998;
- changes in financial staff since 2000 have resulted in a lack of corporate knowledge for past years; and
- Departmental internal audits found significant weaknesses in how the Department manages Program revenues.

History of cost escalation

In 1996 the Department recognized that funding assumptions were unrealistic

10.51 By November 1996, the Department had concluded that its 1994 estimate for required funds and expected revenues were based on a series of assumptions that were no longer realistic. At this point it asked for and the Government approved another year in which to implement the Program. It estimated that it would need an additional $193 million to implement its part of the Program from 1996–97 to completion in 1999–2000. It was given an increase of approximately $166 million. This figure included

- increased funding of about $71 million from the Treasury Board;
- a $40 million "loan" from the Treasury Board that had to be repaid with interest by 2005–06, but which was forgiven in 2000; and
- a reallocation of about $55 million to the Department of Justice from funds earmarked for Correctional Service Canada and the National Parole Board.

10.52 The Department told the Government that it needed the additional funding because major delays in making regulations made it impossible to implement the Canadian Firearms Registration System until early 1998. It also stated that it needed the extra funds because several provinces announced that they would opt-out of implementing the *Firearms Act*. Furthermore, it noted that funding for several needed initiatives was lacking. These initiatives included

- combating trafficking in firearms;
- increasing screening of applicants and notifying former and current spouses of an application as required by amendments to the *Firearms Act*;
- covering lost revenue due to proposed waiving of licensing and registration fees resulting from Aboriginal and treaty rights protected by the Canadian Constitution (the regulations waived fees for sustenance hunters whether or not they were Aboriginal peoples);
- establishing a central licence and registry processing site in New Brunswick;

- training police, customs officers, wildlife officers, prosecutors, and the judiciary on the provisions of the *Firearms Act*;
- obtaining international co-operation and providing international leadership on firearms control;
- co-ordinating policy development with several other federal departments; and
- registering firearms imported and exported by non-residents and businesses.

10.53 The Department also stated that it needed additional money because its original estimates of $5.50 for processing owner licences and $4.60 for processing firearms registrations were too low. These estimates were revised to $23.75 for processing licences and $16.28 for registering a first firearm. As a result of this, the Department estimated that it needed approximately $60 million in additional funds.

10.54 The Department reiterated the need to provide funds to Correctional Service Canada and the National Parole Board. It also noted that project costs could be unpredictable; for example, it could not estimate the expenditures needed to ensure that the information in the Canadian Firearms Registration System and related systems was accurate. Finally, the Department noted that unpredictability about compliance with the Program could have a large impact on costs.

In May 1998, program costs were estimated to be $544 million

10.55 In May 1998, the Department obtained Effective Project Approval for the Canadian Firearms Registration System from the Treasury Board and a total of about $544 million was allocated to the Program for the period 1995–96 to 2002–03. The Department told the Treasury Board Secretariat that the overall Program would achieve its objectives with the approved resources. In November 1998, the Department told the Treasury Board Secretariat that, although certain planning assumptions had changed, the project was going well, and would still be delivered on time and within the approved resource limits.

10.56 However, within weeks of starting to accept applications in December 1998, the Department again concluded that many of its underlying assumptions about funding estimates for the Canadian Firearms Registration System were invalid. It informed the Treasury Board Secretariat of this problem in February 2000.

By February 2000, program cost estimates had increased to $764 million

10.57 In February 2000, the Treasury Board approved further increases to Program funding, bringing the total estimated costs to about $764 million for the period 1995–96 to 2002–03. However, this estimate did not include all Program costs.

10.58 The Department explained to the Government that the increase of $220 million for the period 1999–2000 to 2002–03 was needed because costs for developing and implementing the Program were more than expected. The Department stated that the increase stemmed from significant differences between actual experience and planning assumptions. More specifically,

- a large percentage of businesses had decided to register individual firearms when sold rather than register their inventories before the Program implementation date;
- about 90 percent of the licence and registration applications contained errors or omissions, which was higher than the predicted 20 percent for licences and 40 percent for registrations; and
- initially the Department had predicted that most applications could be handled on paper without having to contact owners; however, high error and omission rates led to it having to contact many more owners than expected.

10.59 The Department also noted that its assumptions about the rate at which it would receive applications for licences and registrations were incorrect. By 1999, only about six percent of an initially estimated three million owners had applied for a licence, and less than three percent of an initially estimated seven million firearms had been registered. Given that so few people were applying for licences, the Department predicted a major backlog would occur just before the 1 January 2001 deadline for licensing. It expected that dealing with the expected backlog would be very difficult, given that it had already had trouble efficiently processing the relatively small number of applications it had received before February 2000.

10.60 The Department concluded that cost recovery could not be achieved as planned. Its actual experience was very different from its assumptions, and revenues were down as a result of low participation. The Department also concluded that revenues would be lower given that it had reduced its estimate of firearms owners by almost 1 million (from 3.2 million to 2.2 million) and firearms by over 1 million (from 7 million to 5.9 million).

By May 2000, the Program cost estimates rose to more than $1 billion

10.61 In May 2000, the Department told the Government that it was implementing a Program Improvement Plan and that it would take another two years, until 2004–05, to fully implement the Canadian Firearms Program. It also estimated that it would need $680 million to implement the Program during the period 2000–01 to 2004–05. The Government approved both the funding increase and the time extension. Together with previous expenditures of $327 million from 1995–96 to 1999–2000, the total forecasted expenditure for the Program was over $1 billion. The Department currently estimates that this expenditure will be offset by $140 million in revenue after refunds by 2004–05.

10.62 The Department stated that the Program Improvement Plan would enable it to license most firearms owners by the 1 January 2001 deadline. Key components of the plan included an aggressive advertising campaign, an outreach initiative, a simplified application form, streamlined processing, an upgrading of the Canadian Firearms Registration System computer system, and the issuing of temporary licences to meet the licensing deadline.

10.63 The Government approved postponing achieving complete cost recovery until the Program was fully operational. This postponement included reducing and waiving some fees. The Department estimated that the Program will be implemented by 2004–05 at a cost of over $1 billion, significantly more than the original estimate of $119 million. It no longer expects fees to cover the cost of developing and implementing the Program since it estimates that it will have collected only about $140 million in revenues after refunds by 2004–05.

In February 2001, a new plan to restructure the Program was approved

10.64 In February 2001, the Government approved a new plan to restructure the Program. The Department told the Government that the Restructuring Plan would reduce future costs by $180 million from 2001–02 to 2004–05. July 2001 departmental documentation indicates that the Department revised downward its estimate of potential savings to a range of $88 million to $128 million. It is unclear whether the Department conducted analyses to justify these estimates of savings, or whether they were simply established targets.

10.65 The Department's March 2002 *Report on Plans and Priorities* to Parliament indicated that during 2002–03 to 2004–05, planned Program spending would total about $289 million. However, in February 2001 the Government was told that the Restructuring Plan would reduce spending during this period to about $170 million.

10.66 The Plan consisted mainly of the following elements:

- reducing excessive regulation,
- replacing the Canadian Firearms Registration System by outsourcing key Program components, and
- consolidating some Program responsibilities located in other departments under the Department.

The program became excessively regulatory

10.67 In February 2001, the Department told the Government it had wanted to focus on the minority of firearms owners that posed a high risk while minimizing the impact on the overwhelming majority of law-abiding owners. However, the Department concluded that this did not happen. Rather, it stated that the Program's focus had changed from high risk firearms owners to excessive regulation and enforcement of controls over all owners and their firearms. The Department concluded that, as a result, the Program had become overly complex and very costly to deliver, and that it had become difficult for owners to comply with the Program.

10.68 The Department said the excessive regulation had occurred because some of its Program partners believed that

- the use of firearms is in itself a "questionable activity" that required strong controls, and
- there should be a zero-tolerance attitude toward non-compliance with the *Firearms Act*.

10.69 In March 2001, the Department told the Treasury Board Secretariat that it was having discussions with police representatives about the enforcement of the licensing requirements. It stated that, in particular, police agencies will be encouraged to exercise discretion case by case, focussing on instances of licensing omissions where there is a clear criminal intent.

10.70 To further reduce the burden and complexity of the Program's requirements and increase the registration rate, the Government authorized substantially reducing the amount of required information and allowing owners to file applications through the Internet. The Department concluded that the amount of information required from applicants exceeded what was needed to classify most types of firearms being registered.

10.71 The Department indicated that owners were having trouble providing all the information needed by the RCMP to properly classify their firearm. The Department told the Government that the registration form discouraged compliance and promoted a high number of errors or omissions, in part because questions were not clear and easily understood. In July 2002, the Department told us the information required on the registration form was "simply reduced to that required by the *Firearms Act* in response to client preference." However, the Department told the Government in March 2001 that the deleted information was not required by the *Firearms Act*.

10.72 About 85 percent of registration applications had to be manually processed because of incomplete information. To deal with this problem, the Government approved a more flexible standard for classifying firearms and directed that the emphasis should be placed on properly classifying firearms that might be restricted or prohibited.

Restructuring involves replacing an expensive, three-year-old computer system

10.73 As previously noted, to control the development of the Program, the Treasury Board designated the entire Program as a Major Crown Project. A major element of the Program is the computer system for the Canadian Firearms Registration System. The scope of the computer system projects were well beyond the Department's previous experience. The Department's internal audits indicate that there were several major project management problems, including a lack of a formal financial reporting framework until the project was well underway, and a high number of orders for changes in the design of the system. For example, the Department told the Treasury Board Secretariat that by 1999 the number of orders for changes for the system was over 1,000.

10.74 In 2001, the Department told the Government that the three-year-old Canadian Firearms Registration System was not working well; its technology was expensive, inflexible, out-of-date, and could not be modified at a reasonable costs to support future operations. Construction and maintenance costs of the existing system were exceptionally high and without radical change, these would represent over 60 percent of future operating costs. This would be significantly higher than the industry norm of 10 percent to 20 percent.

10.75 According to the Department, the Canadian Firearms Registration System information technology was modified several times before and after licensing and registration began in December 1998. The technology was developed in parallel with repeated changes to Program forms, rules, and processes, and before legislation and regulations were finalized. The Department stated that the complexity of the system increased unnecessarily because

- many of the design assumptions were invalid;
- the system was intended to capture detailed information about firearms for criminal investigations and process licence and registration applications; however, the information needed for criminal investigations was well beyond the administrative needs of the Program; and
- small changes, such as modifications in data entry on a form, required major changes in the whole system because of its size and complexity, and these changes typically took three to six months to implement at a cost of millions of dollars.

10.76 The Government approved outsourcing the Canadian Firearms Registration System as part of the Restructuring Program Plan. Outsourcing involved freezing its development, looking for a more cost-effective replacement, and trying to make it more flexible to user needs. A contractor started work in April 2002 to develop a solution. The contractor's proposal involves replacing the System's computer software with existing private sector approaches. The eventual cost of the solution is still to be determined by the Department.

Some responsibilities are being moved to the Department of Justice

10.77 As part of the Restructuring Plan, the Government decided to consolidate some additional statutory authority for the Program under the Minister of Justice. Proposed amendments to the *Firearms Act* will create a Commissioner of Firearms within the Department and transfer the Registrar from the RCMP to the Department. The legislation had not been passed at the time of writing.

10.78 These steps are being proposed because the Department stated it was having trouble maintaining a consistent policy. It stated that it did not have direct control over key functions that resided with other jurisdictions and federal departments, and that its only available lever for maintaining consistent policy was controlling funding. The Department stated that its lack of direct control was a major cause of the Program implementation difficulties, and the reason why the Program focussed on regulation and enforcement of controls rather than on high-risk owners.

Failure to follow Treasury Board's approval processes contributed to problems

10.79 Since the Program is a Major Crown Project, the Department of Justice was expected to follow an approval process for it, intended to minimize the risk of failure and overspending. The Department should have first obtained a Preliminary Project Approval from the Treasury Board and then an Effective Project Approval. With each step, it was expected to provide more complete and definitive information. The project should not have been started until the Effective Project Approval was obtained from the Treasury Board. Subsequent regular reports on implementation were expected, including the use of a framework that allowed comparison of the actual expenditures to those authorized by the Government.

10.80 Contrary to Treasury Board policy, the Department began implementing the Program in December 1995, more than two years before receiving either Preliminary or Effective Project Approval. The Department informed the Treasury Board Secretariat of this in March 1998 when it sought Preliminary Project Approval and the Treasury Board gave its approval in April 1998. The Department also stated that it would implement an accountability structure and properly identify and manage risks. In addition, a Firearms Control Project Interdepartmental Steering Committee was established. Co-chaired by the Deputy Secretary of the Treasury Board and the Department, this Committee was expected to meet monthly, or even more frequently, to address issues and concerns and report to a Government committee. In May 1998, the Treasury Board gave the Department Effective Project Approval.

Poor management contributed to the escalation of costs

10.81 Internal audits conducted by the Department indicated deficiencies such as:

- lack of sufficient strategic planning;
- lack of a national workload management process to balance workloads;
- long-standing problems among the Canadian Firearms Centre and the processing sites involving communications, staff relations, and the need to adapt to changes in direction from the Centre; and
- unilateral decision-making by the Centre even when this was in apparent opposition to the interests of its partners.

10.82 These problems and their implications were not reported to the Government; however, we believe they contributed to the increase in Program costs. The Department told us that the most of the cost increases were due to the reasons that had been reported to the Government.

There were deficiencies in the management of revenues and refunds

10.83 Department of Justice internal audits conducted in 2000 and 2001 raised serious concerns about the control of revenues and refunds. For example, a December 2001 internal audit report identified deficiencies such as the following:

- information on revenue in applicant files was inaccurate, and revenue and licenses could not be reconciled;
- financial information supplied by the Canadian Firearms Centre to the Receiver General for reporting purposes was not timely and complete;
- processing of refund requests was handled manually because the supporting documentation was often incomplete; and
- revenue deposits had gaps in sequentially assigned deposit numbers.

10.84 In April 2002, Program management indicated that it generally agreed with the internal audit observations and that it would take corrective action. Management also stated that a financial capability would be developed as part of contracting out the Canadian Firearms Registration System to manage revenues and refunds.

Conclusion and Recommendation

10.85 The Department of Justice did not provide Parliament with sufficient information to allow it to effectively scrutinize the Canadian Firearms Program and ensure accountability. It provided little financial information and insufficient explanations for the dramatic increase in the cost of the Program. In 1995 the Department told Parliament that the Program would cost $119 million to implement, which would be offset by $117 million in revenues. The Department states that by 2001–02 it has spent about $688 million and collected about $59 million in net revenues after refunds. However, implementation is not yet complete.

10.86 The Department currently estimates that by 2004–05 it will spend at least $1 billion on the Program. This amount does not include all financial impacts on the government. The Department also did not report to Parliament the wider costs of the Program as required by the government's regulatory policy.

10.87 The Department has offered many reasons for the cost escalation, including major delays in passing regulations, provinces opting out of the Program, the need for additional initiatives, wrong assumptions about the rate it would receive applications for licences and registrations, and an excessive focus on regulation and control.

10.88 We requested information from the Department of Justice on Program expenditures and revenues for audit purposes prepared consistent with the reporting framework used by the Department to obtain Government approval of funds for the Program. We stopped our audit when an initial review indicated that there were significant shortcomings in the information provided. We did not believe that a detailed audit would result in substantially different findings. We concluded that the information does not fairly present the cost of the Program to the government.

10.89 Recommendation. The Department of Justice, using a meaningful activity-based reporting framework should annually provide Parliament in its departmental performance report complete, accurate, and up-to-date financial and management information on the following:

- the full costs to develop, implement and enforce the Canadian Firearms Program;
- all revenues collected and refunds made;
- forecast costs and revenues to the point at which the Department expects the Program to become fully operational, including details on outsourcing major components of the Canadian Firearms Registration System and moving certain headquarters functions to Edmonton; and
- complete explanations for changes in costs and revenues, and changes to the overall Program.

Department of Justice Canada's response. The Department of Justice accepts all four recommendations of this audit.

The Department of Justice acknowledges that implementing this program across Canada was a significant logistical, technical and management challenge. In the interest of public safety, and in response to recommendations from the public and Parliament, changes were made to the initial program design that increased its cost. Other factors that contributed to the increased cost include: the development of a complex computer system, the withdrawal of some provinces and territories leaving the federal government to assume responsibilities for administration, and the waiver or reduction of fees to encourage compliance.

The implementation of a restructuring plan, which included a simplified application process and a redesigned system, has already yielded cost reductions. The government has tabled amendments to the *Firearms Act* (C-10) that would further improve program efficiency and allow for alternative means of program delivery.

The licensing and registration phases of the program are nearing completion. Improvements to reporting for this program have already been included in the Report on Plans and Priorities and the Departmental Performance Report. Working with other federal departments and agencies, the department of Justice will provide further information to Parliament on the full costs of the program to the federal government. For example, steps have been taken to report to Parliament in the Main Estimates of 2003–04 and on an annual basis thereafter about program costs.

Public safety is the objective of this initiative, and costs have to be viewed in relation to increased safety achieved with this program. It is worth noting that under the new program, 50 times more license revocations from potentially dangerous individuals have occurred as compared to the last five years of the old program.

The Treasury Board Secretariat's response. The Secretariat notes that the Department of Justice faced significant challenges in implementing a program of this magnitude and originality. More specifically, the program was an unprecedented undertaking marked by significant logistical, policy, design, and legislative challenges.

With regard to program costs, the Secretariat is aware that it was always understood that original estimates would be revised in response to the demands of program implementation. Moreover, the $1 billion estimate for program costs is a forecast through to 2004–05, not a reflection of costs to date.

About the Audit

Objectives

The purpose of this chapter is to present the results of our audit of expenditures and revenues associated with the Canadian Firearms Program. Our specific objectives were as follows:

- To assess whether the statement of financial information prepared by the Department of Justice on the Canadian Firearms Program presents fairly the expenditures and revenues of the Program for the period 1995–96 to 2001–02, on a basis consistent with the framework used by the Department to obtain Government approval of funds for the Program.
- To provide Parliament with information on the changing costs and scope of the Program since its beginning.

Scope

The audit scope includes an examination of information on expenditures and revenues relating to the Canadian Firearms Program, including relevant planning, recording, and reporting aspects that may have financial implications. We did not examine the efficiency and performance of the Program.

Our examination took into account the major events surrounding the development and implementation of the Canadian Firearms Program since 1995–96. We examined information obtained from the Department of Justice, the Royal Canadian Mounted Police, Correctional Service Canada, the National Parole Board, and other federal departments and agencies.

Criteria

We assessed the information on expenditures and revenues relating to the Canadian Firearms Program based on the following audit criteria. The Department of Justice, with respect to expenditures and revenues of the Program, should

- report to Parliament, and the Government complete and accurate financial and related information on expenditures and revenues for the period 1995–96 to 2001–02 on a basis consistent with the reporting framework used by the Department to obtain Government approval of funds for the Program;
- comply with relevant legislation, regulations, and Government decisions and directives;
- have in place the necessary systems and practices to ensure proper financial management, control over transactions, and the reporting of financial information provided to Parliament and others; and
- prepare and report estimates of resource requirements based on complete and accurate information.

Audit team

Assistant Auditor General: Hugh McRoberts
Principal: Alan Gilmore
Directors: Gordon Stock and Ted Bonder

Robert Anderson

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Report of the Auditor General of Canada to the House of Commons—December 2002

Main Table of Contents

Matters of Special Importance—2002
Foreword and Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada—Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada—Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

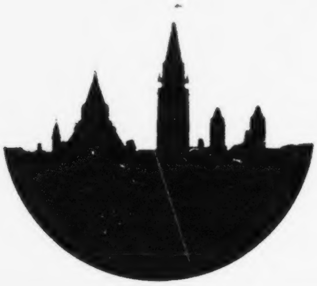
Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

Appendices

2002



Report of the

Auditor General of Canada

to the House of Commons

DECEMBER

Chapter 11

Other Audit Observations

Appendices

Office of the Auditor General of Canada

The December 2002 Report of the Auditor General of Canada comprises 11 chapters, Matters of Special Importance—2002, a Foreword, Main Points, and Appendices. The main table of contents is found at the end of this publication.

The Report is available on our Web site at www.oag-bvg.gc.ca.

For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953
Fax: (613) 954-0696
E-mail: distribution@oag-bvg.gc.ca

Ce document est également disponible en français.

© Minister of Public Works and Government Services Canada 2002

Cat. No. FA1-2002/2-19E
ISBN 0-662-33117-6

Chapter

11

Other Audit Observations

The work that led to other audit observations was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

Table of Contents

Main Points 1

Executive compensation in Crown corporations 3

Compensation needs to be more transparent 3

Royal Canadian Mounted Police—Canadian Firearms Program 8

Information to screen applicants for firearms licences may not be accurate 8

Indian and Northern Affairs Canada 10

Food mail program: A key component of this program has never been fully reviewed 10

Department of Finance 17

Tax arrangements for foreign affiliates have eroded Canadian tax revenues of hundreds of millions of dollars over the last 10 years 17

Parc Downsview Park Inc. 33

An urban park is being created without formal approval by Parliament 33

Atomic Energy of Canada Limited 36

The government has approved Atomic Energy of Canada Limited's five-year corporate plan for the first time since 1994–95 36

Employment Insurance Account 38

No explanation was provided to Parliament for a surplus reaching $40 billion 38

Other Audit Observations

Main Points

11.1 This chapter fulfils a special role in the Report. Other chapters normally report on value-for-money audits or on audits and studies that relate to operations of the government as a whole. Other Audit Observations discusses specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations, and other entities, or during our value-for-money audits or audit work to follow up on third-party complaints. Because these observations deal with specific matters, they should not be applied to other related issues or used as a basis for drawing conclusions about matters not examined.

11.2 During a hearing this year, the Standing Committee on Public Accounts requested that we continue to bring to Parliament's attention previous observations that have not been resolved. In this report, four of the audit observations were previously reported and have been indicated as such.

11.3 This chapter covers new issues:

- Executive compensation in Crown corporations—Compensation needs to be more transparent.
- Royal Canadian Mounted Police—Canadian Firearms Program—Information to screen applicants for firearms licences may not be accurate.
- Indian and Northern Affairs Canada—The food mail program: A key component of this program has never been fully reviewed.

11.4 The chapter also covers issues previously updated:

- Department of Finance—Tax arrangements for foreign affiliates have eroded Canadian tax revenues of hundreds of millions of dollars over the last 10 years.
- Park Downsview Park Inc.—An urban park is being created without formal approval by Parliament.
- Atomic Energy of Canada Limited—The government has approved Atomic Energy of Canada Limited's five-year corporate plan for the first time since 1994–95.
- Employment Insurance Account—No explanation was provided to Parliament for a surplus reaching $40 billion.

Executive compensation in Crown corporations

Compensation needs to be more transparent

In brief

Our review indicated inconsistencies in how the federal Crown corporations manage the overall compensation for their executives. The Privy Council Office and the Treasury Board Secretariat need to provide clear guidance to Crown corporations to ensure that their compensation practices are based on established principles that are clearly understandable by the stakeholders involved. The government needs to adopt disclosure practices to increase transparency.

Background

11.5 Crown corporations have more freedom than federal departments and agencies with regard to compensation packages they give to their executives. As part of our annual financial audits, our Office examined how Crown corporations handled executive compensation. We examined 43 Crown corporations over a three-year period by reviewing some each year. In the government's view, Crown corporations are established at arm's length from the government. They have their own corporate governance structure. They are expected to be competent to run their own affairs. The Crown Corporation General Regulations provide some direction concerning remuneration and benefits for the chief executive officers. The remuneration for the chief executive officers is managed centrally in the majority of cases.

11.6 Executive compensation comprises salaries, pensions, performance pay, termination benefits, and other benefits such as annual leave, short- and long-term disability insurance, life insurance, health and dental plans, social or recreational club memberships, and the use of company vehicles. We examined only the compensation of chief executive officers or presidents, and those one level below them—typically vice-presidents.

Prudence and probity—Two values that are the building blocks for good accountability.

11.7 The purpose of our review was to determine whether executive compensation in federal Crown corporations is understandable, transparent, and consistent with the public sector values of prudence and probity. We expected to find complete and accurate information that was readily available, and a set of clear laws, regulations, and rules to adequately guide Crown corporations. We also expected to find that each Crown corporation would follow the rules that apply to its own situation. One method of increasing openness or transparency is by revealing or disclosing more information. We examined disclosure practices in other jurisdictions.

Authorities governing compensation

11.8 The remuneration of the chief executive officer or the president of a federal Crown corporation is fixed by the Governor in Council, at a salary range that is recorded publicly in an order-in-council. Although this means that the chief executive officer's salary range is known, the actual salary level and other benefits are not. That is considered to be personal information. Nor is the compensation of vice-presidents disclosed. Crown corporations that are subject to the *Privacy Act* are prevented from disclosing personal information.

11.9 There are different rules governing the compensation of chief executive officers and vice-presidents. A number of laws or regulations apply to chief executive officers: the *Financial Administration Act*, the law governing each corporation, and the Crown Corporation General Regulations. The *Financial Administration Act* requires that the Governor in Council set the rate of remuneration. The Regulations define remuneration for the purposes of the *Financial Administration Act* to mean a salary, a fee, an allowance or any other form of monetary compensation, except monetary compensation payable under the provisions of a registered pension plan. The *Financial Administration Act* further specifies that the board of directors of a corporation has the authority to provide any benefits other than remuneration to the chief executive officer at any time. The Crown Corporation General Regulations require that when additional benefits are provided, the corporation must advise the responsible minister and the Clerk of the Privy Council within a specified length of time.

11.10 For compensation of vice-presidents, the laws that govern a corporation normally give the board of directors overall administrative responsibility. The governing legislation also allows a board of directors to delegate administrative authority to the committee responsible for human resource management or to the executive committee, which are subcommittees of the board. As an alternative, the chief executive officer may be charged with the responsibility for compensation of all of the corporation's employees, including vice-presidents.

11.11 In 1997, the President of the Treasury Board asked the Advisory Committee on Senior Level Retention and Compensation to examine compensation of senior public servants in departments and agencies. The President also asked the Committee to review compensation for the chief executive officers appointed to Crown corporations by the Governor in Council. For the corporations we examined, the Committee recommended a salary range of $113,200 to $325,200 for chief executive officers and a performance pay range of 10 percent to 20 percent of the salary, effective April 2001. However, the Committee excluded compensation of vice-presidents from its review because employee compensation is outside its mandate.

Issues

Notifying responsible authorities

11.12 A corporation's board of directors can set any benefits other than remuneration for the chief executive officer, in accordance with the Crown Corporation General Regulations. However, the Regulations provide little guidance on the principles that boards are to apply. For instance, the Regulations state that benefits shall not exceed the total or aggregate value of standard benefits for chief executive officers in other corporations in the public and the private sectors that carry on similar activities. We found that neither the Privy Council Office nor the Treasury Board Secretariat has provided clear guidance to Crown corporations on how to establish standard benefits or how to determine which of their activities are similar to those of private sector corporations.

11.13 The Regulations further state that when a board of directors provides benefits to a chief executive officer, the corporation must report them to the responsible minister and to the Clerk of the Privy Council. We noted that three Crown corporations neglected to do that. The three Crown corporations notified the Privy Council Office when we brought this issue to their attention.

11.14 Most Crown corporations do not have their own pension plan. Their employees are subject to the same public service superannuation plan as the public service employees. We found that practices varied in the larger, more commercial corporations that have their own pension authority. A number of corporations had supplementary pension plans for executives, usually approved by the board of directors. Pension benefits are an important part of the overall compensation.

Rationale for pay inversion is not clear

11.15 Pay inversion occurs when the combined total of salary and performance pay paid to a subordinate employee is greater than what is paid to his or her supervisor. The Advisory Committee on Senior Level Retention and Compensation noted in its 2000 report that situations of pay inversion exist in some larger Crown corporations. Our review confirmed these findings.

11.16 In August 2002, the Committee noted that in a few corporations, the vice-presidents are paid more than the chief executive officers. It also observed that the chief executive officers' total compensation lags behind that of comparable positions in the total Canadian markets. The Committee concluded that a fundamental review of the compensation policy for chief executive officers needs to be undertaken. We support the Committee's recommendation for such a review.

11.17 We noted significant inversions in pay for the positions of chief executive officers and vice-presidents in a small number of Crown corporations. In these cases, the vice-presidents' salary and performance pay were significantly higher than the total amount of the chief executive officers' salary and performance pay combined.

11.18 The inversions generally occur because the vice-president's performance pay varies, with no predetermined limit on the total amount that can be given. However, the chief executive officer's performance pay is a percentage of the salary at a rate fixed by the Governor in Council on the recommendation of an external review committee. We understand that the use of variable performance pay as a significant component of overall compensation is common in the private sector.

11.19 Depending on a Crown corporation's particular strategy to recruit and retain staff, pay inversions may be appropriate. Currently there are no guidelines governing pay inversions. Although the Treasury Board Secretariat is responsible for applying the *Financial Administration Act* to Crown corporations, it provides little guidance on compensation at levels below the chief executive officer. There is no predetermined limit on total compensation for the position of vice-president of a Crown corporation on a government-wide basis.

11.20 The Advisory Committee on Senior Level Retention and Compensation recommended salary and performance pay levels for chief executive officers in 2001 and 2002. However, we noted that the Privy Council Office has not provided guidance to Crown corporations on suitable comparisons from the private sector of overall benefits other than remuneration for chief executive officers.

Disclosure practices in other jurisdictions

11.21 We believe that releasing information about executive compensation by Crown corporations can increase openness with the public. Disclosure practices can vary in different jurisdictions depending on the legislation or regulation in effect. Currently in Canada, the salary range of the chief executive officer of Crown corporations is disclosed to the public. However, the actual salary or other forms of compensation such as the pension entitlements, termination benefits, or other benefits are not disclosed because they are personal information. As well, there is no disclosure of executive compensation for levels below the chief executive officer. However, we noted that the Canada Pension Plan Investment Board disclosed detailed information about executive compensation in its annual report as required by the Canada Pension Plan Investment Board Regulations. This organization is not subject to the *Privacy Act*.

11.22 We examined disclosure practices of executive compensation in Crown corporations within provincial governments. By legislation, some provinces are required to disclose it; other provinces are not. Ontario, for instance, releases information to the public about the total compensation for executives and employees whose earnings are above $100,000. Ontario's *Public Sector Salary Disclosure Act, 1996* covers city and other local governments, universities, colleges, school boards, hospitals, and Crown agencies. Most Crown corporations in Ontario, except for commercial corporations, are required to disclose the information.

11.23 We also examined disclosure practices in private and public sectors in other countries. For public sector organizations similar to Crown corporations, disclosure is required in the United States, Australia, and New Zealand. In the United Kingdom, only certain organizations that raise part of their funding in the private sector are required to disclose information. In the private sector, we found more consistent disclosure. Specifically the securities regulators in Canada and in the United States require that compensation for key executives of publicly traded companies must be disclosed to the public. The disclosure includes overall compensation rather than just salary. If the Crown corporations wish to align compensation practices in part with those of the private sector, then in our view they should also adopt their disclosure practices.

Conclusion

11.24 As part of the public sector, Crown corporations need to follow a more consistent and transparent approach to executive compensation. We found the Crown Corporation General Regulations to be too general to apply in these circumstances. In our view the comparison between the public and private corporations needs to be clarified through guidance. The Advisory Committee on Senior Level Retention and Compensation recommended salary and performance pay levels for the chief executive officers.

11.25 **Recommendation.** The Privy Council Office and the Treasury Board Secretariat should clarify the principles that govern compensation for both chief executive officers and vice-presidents, including the issue of pay inversion. They should also monitor the practices of Crown corporations and ensure that they are consistent with the governing authorities.

11.26 **Recommendation.** The Privy Council Office and the Treasury Board Secretariat should provide more integrated guidance to compare executive compensation in Crown corporations against those in private sector corporations. For example, they could develop more guidance for comparable benchmarks to determine which activities are similar to those of the private sector corporations.

11.27 **Recommendation.** In addition to providing guidance, the federal government should adopt disclosure practices for executive compensation, taking into account similar practices in other jurisdictions, with the view to increasing transparency.

Audit team

Assistant Auditor General: Jean Ste-Marie
Director: Sue Morgan

Camille Gilbert
Arthur Miskew

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Royal Canadian Mounted Police—Canadian Firearms Program

Information to screen applicants for firearms licences may not be accurate

In brief

As part of the Department of Justice's Canadian Firearms Program, the Royal Canadian Mounted Police (RCMP) operates a database of about four million records called the Firearms Interest Police. Chief Firearms Officers use this database to help screen applicants for firearms licences. The RCMP provides about 1 million of these records. The RCMP told us that while it believes that the database has significantly improved public safety, it remains concerned about the reliability of the information it provides to the database. This matter came to our attention as part of our follow-up to our study of challenges to the criminal justice system, reported to Parliament in our April 2002 Report, Chapter 4.

Background

11.28 The Department of Justice's Canadian Firearms Program requires that the Chief Firearms Officers screen applicants for firearms licences in order to help ensure public safety. The Officers use the Firearms Interest Police database to help screen applicants.

11.29 The RCMP indicates that over 900 police agencies contribute information to the database. It contains information on individuals who have had contact with the police, including those that have been charged with an offence. The RCMP provides about 1 million of the records in the database. These records are extracted from the RCMP's Police Information Retrieval System database. The RCMP reviewed the quality of the records it provides. The data supplied by other police agencies were not reviewed.

Issues

11.30 In November 1998 and March 2000, the Senior Executive Committee of the RCMP was informed that officers responsible for the RCMP's contributions to the Firearms Interest Police database had serious concerns about the accuracy and completeness of the information. We reviewed RCMP files and made other inquiries to confirm the significance of these concerns.

11.31 An April 2001 RCMP review of data quality stated that

- persons are known to be in the database who should not be, and thus could be denied firearms licences or have their eligibility reviewed; and
- some persons who should be in the database are not and these individuals could be issued licences and subsequently use firearms to commit a violent offence.

The review concluded that a tragic incident could arise as a consequence of the poor data quality and that the RCMP therefore faces serious legal risks.

11.32 In 2002, the RCMP further indicated that the quality of the data was still questionable.

Conclusion and recommendation

11.33 The RCMP's concerns about the data are based on the limited reviews it has conducted. If what these RCMP reviews show is representative of the risks that the database presents, then remedial action must be taken immediately. However, to be effective, such action must be based on an urgent systematic identification of the problems in the database and potential solutions.

Royal Canadian Mounted Police's response. The Royal Canadian Mounted Police (RCMP) is aware of the concerns about the quality of some data in its Police Information Retrieval System and its impact on the Canadian Firearms Program. The RCMP considers public safety to be paramount. For this reason, the RCMP is committed to ensuring that individuals who do not meet the legal requirements to be issued a firearms licence are identified through proper information sharing.

The RCMP recognizes that effective information sharing for the purposes of the Canadian Firearms Program is critical, and that this is dependent on the integrity of the data contained in police information systems, including those of the RCMP. The RCMP has implemented a number of remedial measures to address data quality issues. These include a record disclosure and verification process, system-level error detection and reporting mechanisms, enhanced system user awareness regarding data quality issues, development of additional data quality reviewer expertise, progress and compliance monitoring, and an increased level of accountability on the part of contributors to RCMP systems for their data quality.

The RCMP opens 2.9 million operational case records per year, from over 750 locations throughout Canada. The measures specified to address data quality in the RCMP's Police Information Retrieval System are already proving to be effective.

Audit team

Assistant Auditor General: Hugh McRoberts
Principal: Alan Gilmore
Director: Ted Bonder

For information, please contact Communications at (613) 995-3708
or 1-888-761-5953 (toll-free).

Indian and Northern Affairs Canada

Food mail program: A key component of this program has never been fully reviewed

In brief

Since the late 1960s, the federal government has been subsidizing Canada Post's costs of sending nutritious perishable food to Canada's North by air. The objective of the food mail program is to increase the level of nutrition in the diets of those living in the North, all within a reasonable cost to the government. Users of the program must arrange with wholesalers to send food that is eligible under the program to Canada Post facilities at one of the 20 designated entry points. Canada Post then assumes the responsibility for flying the perishable food to any one of 140 communities in the North within 48 hours.

Yet Indian and Northern Affairs Canada has never reviewed the impact of the entry points on the effectiveness of the program. There have been calls for such a review because more southerly cities might prove to be more efficient. This is particularly true for entry points such as Val-d'Or, Happy Valley-Goose Bay, Yellowknife, and Churchill. We are proposing that Indian and Northern Affairs Canada conduct such a review.

Background

11.34 Since Aboriginal people in the North have faced many changes in their lifestyle, they are no longer able to obtain all of their food from the land and sea. This gives increasing importance for the need for nutritious foods at an affordable price.

11.35 While there are a variety of ways to meet that need, such as educating Northerners about what constitutes a nutritious diet and working to increase their income, keeping the cost of nutritious foods low contributes to the nutrition of Northerners. It is therefore important that nutritious food from the South be shipped at an affordable price to all of the 140 northern communities.

11.36 In the late 1960s, the federal government determined that by subsidizing the costs of mailing food to the North, it could improve the nutrition and health of Northerners. With that in mind, the government introduced the Northern Air Stage Program, generally known as the "food mail program." The program is intended to provide a subsidized rate to mail fresh nutritious foods and other essential items to the North.

11.37 In 1989, Indian and Northern Affairs Canada undertook a review to determine what role, if any, the government should continue to play in the program. The review pointed to the program's importance in both decreasing the cost of perishable nutritious food and increasing its consumption. At a parliamentary committee hearing in 1998, the Department informed committee members that while the consumption of nutritious food had increased since the program began, it was still below recommended levels—particularly the consumption of fruit, vegetables, and dairy products in isolated communities.

11.38 In 1996, the government agreed to continue the program but with a yearly cap of $15.6 million. For the most part, the program stayed within that budget up to 1999–2000. But in 2001–02, spending grew to $24.5 million. This was brought on by increased demand for the program as well as increased costs due to the contract that Canada Post had with its carriers. The Department funded the additional costs by using Supplementary Estimates to reallocate money from elsewhere in the Department.

11.39 The program is still delivered by Canada Post through an airport-to-airport subsidized postal freight service for communities that do not have year-round access by road. When the program began, it was limited to northern Quebec and Ontario. Today, about 90,000 people are eligible for the program in some 140 communities—in virtually all of Nunavut and parts of northern Quebec, Labrador, Ontario, Alberta, Saskatchewan, Manitoba, the Yukon, and the Northwest Territories. In 2001–02, these communities received about 10 million kilograms of food; Nunavut and northern Quebec received about 60 percent and 30 percent respectively of that total shipment.

11.40 The entry points where food must be delivered for shipment to the north are limited to 20 designated communities with airports. For example, Val-d'Or serves all of Baffin Island and northern Quebec, while Happy Valley-Goose Bay in Labrador serves northern and central Labrador, and Churchill serves the Keewatin (Kivalliq) area. Exhibit 11.1 shows a map of Canada illustrating some of the entry points and communities served by the program.

How the program works

11.41 Although Indian and Northern Affairs Canada sets the policy for the program, Canada Post delivers it on a day-to-day basis. How a Northerner in a designated community actually receives subsidized goods is described in Exhibit 11.2.

Issues

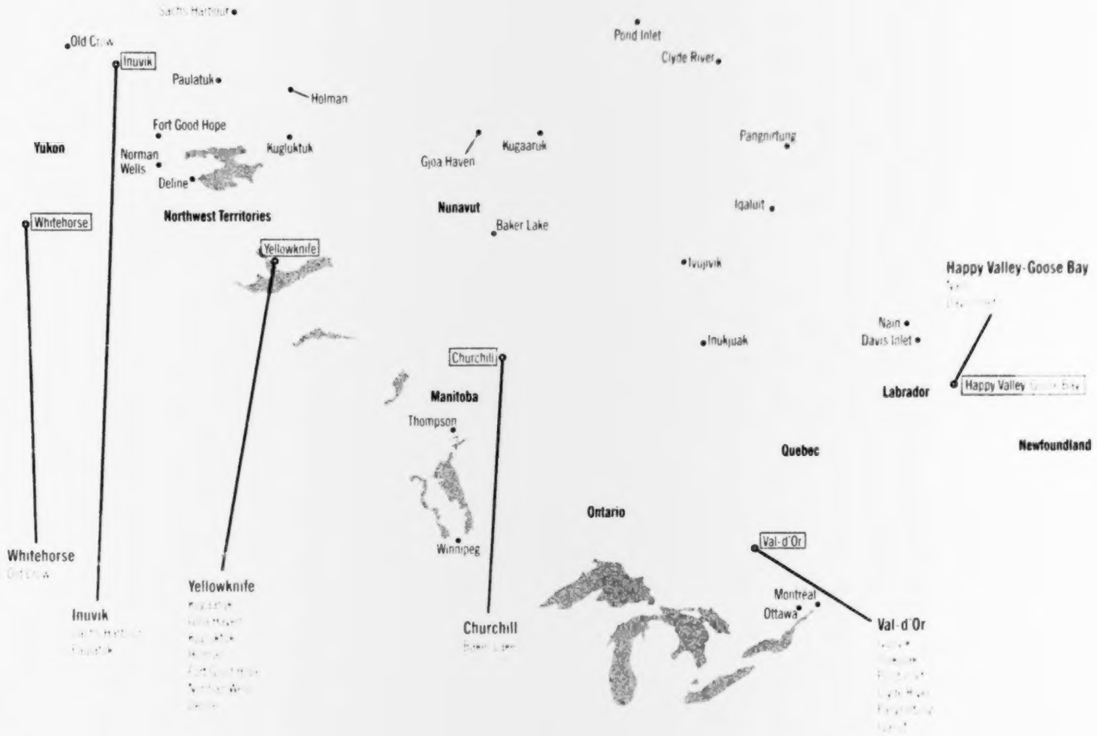
Location of entry points and the effect on food quality and choice

11.42 We believe that this program contributes to the nutrition of Aboriginal people and others in the North by keeping the price of fresh nutritious foods affordable. We also found that the people involved in delivering this program are committed to its success and believe that the program really matters.

11.43 However, we also discovered that no systematic review had ever been done to assess whether changing the entry points would make the program more effective.

11.44 A 1996 study conducted by Indian and Northern Affairs Canada revealed that many northern merchants and consumers have suggested that access to more southerly entry points would have a positive impact on the quality and choice of food. For example, Montréal or Ottawa should be considered as a possible alternative to Val-d'Or; Winnipeg or Thompson, Manitoba, should be considered in addition to, or instead of, Churchill. We would have expected to find a review of major entry points but were unable to do so.

Exhibit 11.1 Food mail program—Some of the entry points and final destinations


Sachs Harbour
Old Crow
Inuvik
Paulatuk
Holman
Fort Good Hope
Yukon
Norman Wells
Deline
Kugluktuk
Whitehorse
Northwest Territories
Yellowknife
Pond Inlet
Clyde River
Gjoa Haven
Kugaaruk
Pangnirtung
Nunavut
Iqaluit
Baker Lake
Ivujivik
Happy Valley-Goose Bay
Nain
Davis Inlet
Inukjuak
Churchill
Manitoba
Labrador
Happy Valley
Thompson
Quebec
Newfoundland
Ontario
Val-d'Or
Winnipeg
Whitehorse
Yellowknife
Montreal
Ottawa
Inuvik
Churchill
Val-d'Or

11.45 The Department conducted a survey about food quality in 2001, which revealed that there was a lack of quality and variety of fresh and frozen perishable foods in Labrador. Customers have clearly and repeatedly said that they were not satisfied with the quality of the products sold in their communities. They were also dissatisfied because they believed these products were too expensive. At the same time, the retailers who responded to the survey said that there were no serious problems with the products sold in their stores. According to them, these products were of good quality and there was a large variety of fresh and frozen perishable foods made available to their customers at all times. A key finding of this survey was the gap between the views of customers and retailers about the quality of the food.

11.46 During the course of conducting price surveys, the staff of the Department also found that food quality can sometimes be poor, particularly in smaller communities in Labrador and Nunavut. Although the Department and Canada Post work with wholesalers and retailers to improve the packaging and storing of food, they have made no effort to determine whether having food shipped from more southerly cities would improve the quality of food.

Exhibit 11.2 How the program works

- The program starts with a retailer, or in some instances, an individual consumer living in a designated northern community like Iqaluit or Pond Inlet, who wants to purchase an item that is eligible for a subsidy. (Designated communities and eligible products are listed in a food mail program guide from Indian and Northern Affairs Canada on its Web site at http://www.ainc-inac.gc.ca/ps/nap/air/index_e.html
- The retailer places the order with a wholesaler in the South (for example, Montréal or Edmonton) who has a contract with Canada Post to supply food or eligible products under the food mail program.
- The wholesaler must deliver the item from his or her warehouse to one of 20 designated Canada Post entry points, which are located at the airports in those communities, for example, Val-d'Or, Happy Valley-Goose Bay, Churchill, or Inuvik. Generally this is done by road or rail. In the case of Val-d'Or, food takes between 5-7 hours by road from Montréal; for Happy Valley-Goose Bay, it takes up to 60 hours from Montréal by road.
- When the item is delivered to the entry point, there are limitations regarding weight, size, and packaging quality. (These are all described in the food mail program guide.)
- Canada Post randomly checks the content of packages to be sure that the items are eligible under the program. There are a number of classes of eligible products. While they all receive the same subsidized rate per package, there are three different per-kilogram rates—$0.80, $1.00, and $2.15, depending on the specific product and destination.
- Canada Post then takes responsibility for delivering the product to one of the 140 final destinations from one of 20 entry points. It guarantees that the item will be delivered to any of these eligible communities in the North within 48 hours for perishables and 72 hours for non-perishable foods.
- All shipments must be picked up at the airport within 15 minutes of the time that the aircraft arrives. The carrier must notify the retailer or individual person who placed the order when the plane is scheduled or anticipated to arrive.
- The retailer or individual pays the wholesaler the full cost for the item. This includes the cost of packing the product for delivery, the cost of getting it to the entry point, and the subsidized rate that Canada Post charges for the service.
- The federal government pays Canada Post the difference between the subsidized rate and the rate that would be charged if there was no subsidy.

Location of entry points and relationship to overall program budget

11.47 The rationale for selecting the entry points was that the air distance from the entry point to the individual northern communities served was the shortest possible. The presumption was that road and rail travel to the entry point was cheaper and therefore the cost to the consumer would be the lowest possible, given the amount the federal government was willing to commit to the program.

11.48 Since the program began, there has not been any assessment of this concern. Yet it is a simple fact that planes are not constrained by the location of roads. Take, for example, a shipment of food going to Iqaluit. At this time the food often travels from Montréal to Val-d'Or, which takes about five to

Exhibit 11.2 **How the program works**

- The program starts with a retailer, or in some instances, an individual consumer living in a designated northern community like Iqaluit or Pond Inlet, who wants to purchase an item that is eligible for a subsidy. (Designated communities and eligible products are listed in a food mail program guide from Indian and Northern Affairs Canada on its Web site at http://www.ainc-inac.gc.ca/ps/nap/air/index_e.html.)
- The retailer places the order with a wholesaler in the South (for example, Montreal or Edmonton) who has a contract with Canada Post to supply food or eligible products under the food mail program.
- The wholesaler must deliver the item from his or her warehouse to one of 20 designated Canada Post entry points, which are located at the airports in those communities, for example, Val d'Or, Happy Valley-Goose Bay, Churchill, or Inuvik. Generally this is done by road or rail. In the case of Val d'Or, food takes between 5-7 hours by road from Montreal. For Happy Valley-Goose Bay, it takes up to 60 hours from Montreal by road.
- When the item is delivered to the entry point, there are limitations regarding weight, size, and packaging quality. (These are all described in the food mail program guide.)
- Canada Post randomly checks the content of packages to be sure that the items are eligible under the program. There are a number of classes of eligible products. While they all receive the same subsidized rate per package, there are three different per-kilogram rates ($0.80, $1.00, and $2.15) depending on the specific product and destination.
- Canada Post then takes responsibility for delivering the product to one of the 140 final destinations from one of 20 entry points. It guarantees that the item will be delivered to any of these eligible communities in the North within 48 hours for perishables and 72 hours for non-perishable foods.
- All shipments must be picked up at the airport within 15 minutes of the time that the aircraft arrives. The carrier must notify the retailer or individual person who placed the order when the plane is scheduled or anticipated to arrive.
- The retailer or individual pays the wholesaler the full cost for the item. This includes the cost of packing the product for delivery, the cost of getting it to the entry point, and the subsidized rate that Canada Post charges for the service.
- The federal government pays Canada Post the difference between the subsidized rate and the rate that would be charged if there was no subsidy.

Location of entry points and relationship to overall program budget

11.47 [illegible]

11.48 Since the program [illegible] concern [illegible]. Take, for example, a shipment [illegible]. At this time the food [illegible] from Montreal to Val d'Or [illegible] seven hours by road. Then the package is flown from Val-d'Or to Iqaluit. Yet the air distance from Montréal to Iqaluit is just 220 kilometres longer than from Val-d'Or to Iqaluit. Alternatively, the food could be flown from Ottawa to Iqaluit, an air distance of 260 kilometres further than from Val-d'Or to Iqaluit.

11.49 In fact for parcels that do not qualify under the food mail program, Canada Post charges the same rate to Iqaluit, no matter whether the parcel originates in Ottawa or Val-d'Or. This means that shipping such packages from Ottawa to Iqaluit rather than trucking them to Val-d'Or is not more expensive when using regular Canada Post and it saves at least five to seven hours. The same would apply to parcels from Montréal to Iqaluit versus Val-d'Or to Iqaluit. Furthermore, the planes that are used to transport food from Val-d'Or to the North using this program all originate in Ottawa. Whether or not it is less expensive to transport the food from Ottawa directly to the northern communities is based on a number of assumptions. One of these is having enough food storage facilities in Ottawa to handle the increased amount of food mail through that centre. Improving the quality of the food that arrives in the North would depend on factors such as whether the delay at the Ottawa airport is longer or shorter than the delays now faced at the Val-d'Or airport.

11.50 We have also been told that if other entry points are opened in larger centres, it could lead to an increase in the use of the program. The dilemma that officials face is that this program has a budget that is capped at $15.6 million.

Location and impact on community

11.51 When the program began, Val-d'Or and Montréal were selected as the entry points for northern Quebec and the Baffin region. However, Montréal was dropped in the mid-1980s. As the program grew, other entry points were selected. Today, an infrastructure has grown around the food mail program in its major locations. This includes the growth of businesses associated with the program and the hiring of staff to manage it. We recognize changing an entry point or opening up additional entry points, which may compete for the same shipments, would have an effect on these infrastructures which have already built up at the existing entry points. These impacts should be considered during the review.

Conclusion

11.52 Low food prices have a great effect on the decision by Northerners to buy nutritious food. The food mail program clearly makes it easier for them to buy fresh nutritious food at reasonable prices. But how effective the locations of the entry points are to the overall quality and price of nutritious foods, as well as the cost to Indian and Northern Affairs Canada, has never been reviewed.

11.53 We believe that the Department has sufficient reason to assess how effective the locations of the major entry points are, particularly Val-d'Or, Happy Valley-Goose Bay, Churchill, and Yellowknife. Interviews and surveys done by program officials all point to the fact that the entry points and the quality and nutrition levels of the foods being sent to the North through this program are related. Officials and users of the program have told us that having entry points in more southerly locations might be better if it leads to a greater choice in food. More competition could lead to an improvement in quality, which may in turn lead to a corresponding increase in the use of the program.

11.54 However, all the evidence we could gather is either informal or a matter of opinion. We could not find any systematic review of the effect that changing the entry points would have. We did, however, find that officials had discussed such a review over a number of years, but nothing had materialized.

11.55 **Recommendation.** Indian and Northern Affairs Canada should undertake a review of the location of its major entry points.

11.56 Such a review should focus on whether the existing points are the most effective in terms of contributing to the overall levels of nutrition in the North. That review would look not only at the financial costs and benefits associated with existing and alternative locations, but also the less tangible, but equally important issues such as quality, freshness, variety of foods, and how long it would take to deliver the food items from entry points located farther south.

Department's response. The goal of the food mail program is to provide good-quality, affordable, nutritious food to isolated northern communities. This program is an important element in our continuing efforts to improve the health of northern communities.

Action was taken in 2001 to address the issue of Inuvik as a food mail entry point, by reducing the rate charged for shipping perishable food from this remote entry point to other communities in the Beaufort-Delta region. The Department will continue to examine alternatives, on a case-by-case basis, where there is clear evidence that the existing entry points are adversely affecting the quality or price of foods in northern communities. As resources permit, the Department will also consider requests for designating additional entry points from stakeholders or other levels of government.

The primary focus of the Department will continue to be on enhancing program effectiveness under the existing network, including improving food quality under the Food Mail Quality Assurance Initiative being phased in across the system, seeking the funds necessary to avoid postage rate increases for food mail service, and implementing pilot projects in selected communities to assess the impact of rate reductions for the most critical perishable foods, combined with nutrition education and retail promotion of healthy foods.

Audit team

Assistant Auditor General: Ronald C. Thompson
Principal: Jeff Greenberg

Stacey Wowchuk

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Department of Finance

Tax arrangements for foreign affiliates have eroded Canadian tax revenues of hundreds of millions of dollars over the last 10 years

In brief

In 1992, we expressed concern that tax arrangements for foreign affiliates resulted in hundreds of millions of dollars in reduced tax revenues. Following our Report, the House of Commons Standing Committee on Public Accounts held hearings and made recommendations to the Department of Finance Canada in 1993. While legislative changes have been made, we are still concerned. The Minister of Finance's Technical Committee on Business Taxation also examined the issues and reported on them in 1997.

The report of the Technical Committee noted that Canada's rules have allowed foreign-owned multinationals to shift debt into Canada and have encouraged tax planning mechanisms that erode Canadian tax revenues. We observed transactions where foreign-owned Canadian corporations incurred over $3 billion of debt to finance investments in third countries. The interest on that debt is deducted from Canadian income before taxes. It results in a loss of revenue for both federal and provincial governments.

We also observed a transaction, for example, where a foreign affiliate of a foreign-owned Canadian corporation was used to move $500 million in capital gains from Canada to Barbados tax-free. In 2000, Canadian corporations received $1.5 billion of virtually tax-free dividend income from their affiliates in Barbados (compared with $400 million in 1990). We noted that Barbados and Malta changed their tax rules to bypass our law—to accommodate foreign affiliate investments. Tax arrangements for foreign affiliates continue to erode Canadian tax revenues.

Background

11.57 In 1992 we reported on tax arrangements for foreign affiliates of Canadian corporations. We were concerned about the following issues:

- the rules for deducting interest;
- tax-exempt dividends from foreign affiliates;
- taxable dividends from foreign affiliates; and
- the rules for foreign accrual property income (passive income such as interest).

11.58 Following our Report, the House of Commons Standing Committee on Public Accounts held several hearings. On 23 April 1993, the Committee issued its report and in 1995 a number of legislative changes were made. The 1997 report of the Minister of Finance's Technical Committee on Business Taxation also dealt with the issues we previously reported on.

11.59 This audit observation follows up on our 1992 concerns.

Interest deductibility

The concerns we had in 1992

11.60 [illegible]

11.61 [illegible]

The Public Accounts Committee was concerned about interest deductibility rules

11.62 [illegible]

Exhibit 11.3 Double-dip financing structures

A company can significantly reduce its effective rate of borrowing with a type of arrangement referred to as a double-dip financing structure. These structures allow taxpayers to obtain at least two interest deductions on the amount of money borrowed.

Example of a transaction

Company A, which is Canadian, borrows $275 million. The interest on the $275 million reduces Canada's tax base because "A" writes this expense off against its Canadian income before taxes. This is the first interest deduction.

Company A then invests the $275 million in shares of its Barbados and Netherlands subsidiaries. These subsidiaries then loan the $275 million to a United States subsidiary of "A." The U.S. subsidiary deducts the interest it pays to the Barbados and Netherlands subsidiaries from its U.S. income. This is the second interest deduction. Even though the Barbados and Netherlands subsidiaries receive interest income from the U.S. subsidiary, they will pay little or no tax on that income because of low tax rates in Barbados and the Netherlands.

Under Canadian tax law, the interest income, which is passive income that the Barbados and Netherlands subsidiaries receive from the U.S. subsidiary, is redefined as active business income. Because it is considered active business income it can be received in Canada as a tax-free dividend (paragraphs 11.79, 11.80, 11.81).

11.63 The committee recommended in [illegible] that the Department of Finance study in depth the problem of deducting interest [illegible] purposes of the tax laws. The committee also recommended that the

Issues

Interest deductibility

The concerns we had in 1992

11.60 When a Canadian corporation carries on business outside Canada through a foreign affiliate, the interest expense charged on the money borrowed to invest in the operations of the foreign affiliate can be deducted in Canada (interest deductibility). However, the related income is usually taxable only in the foreign jurisdiction.

11.61 We were concerned about this because deducting interest from a business's income in Canada reduces Canada's tax revenues, but the income related to that interest is not usually taxed in Canada. The related income may be received as a tax-exempt dividend and it may never be subject to any Canadian tax.

The Public Accounts Committee was concerned about interest deductibility rules

11.62 The House of Commons Standing Committee on Public Accounts noted that being able to deduct interest expenses without being able to tax the related income earned through the foreign affiliate gives cause for concern. This is particularly so because some taxpayers are using the rules to obtain an interest deduction for the same investment in two or more different jurisdictions. This type of transaction is a "double-dip" financing structure (Exhibit 11.3).

Exhibit 11.3 Double-dip financing structures

A company can significantly reduce its effective rate of borrowing with a type of arrangement referred to as a double-dip financing structure. These structures allow taxpayers to obtain at least two interest deductions on the amount of money borrowed.

Example of a transaction

Company A, which is Canadian, borrows $275 million. The interest on the $275 million reduces Canada's tax base because "A" writes this expense off against its Canadian income before taxes. This is the first interest deduction.

Company A then invests the $275 million in shares of its Barbados and Netherlands subsidiaries. These subsidiaries then loan the $275 million to a United States subsidiary of "A." The U.S. subsidiary deducts the interest it pays to the Barbados and Netherlands subsidiaries from its U.S. income. This is the second interest deduction. Even though the Barbados and Netherlands subsidiaries receive interest income from the U.S. subsidiary, they will pay little or no tax on that income because of low tax rates in Barbados and the Netherlands.

Under Canadian tax law, the interest income, which is passive income that the Barbados and Netherlands subsidiaries receive from the U.S. subsidiary, is redefined as active business income. Because it is considered active business income it can be received in Canada as a tax-free dividend (paragraphs 11.79, 11.80, 11.81).

Source: Canada Customs and Revenue Agency

11.63 The Committee recommended in 1993 that the Department of Finance study in depth the problem of deducting interest charges before making changes to the tax laws. The Committee also recommended that the

Department send the results of the study to them for review. The Department has not yet completed its study. However, the Minister of Finance's Technical Committee on Business Taxation examined the issue and reported on it in 1997.

11.64 While double-dip financing structures may allow Canadian multinationals to expand and compete in the global marketplace, they also provide the same incentive to foreign-owned multinationals.

11.65 Double-dip financing structures encourage foreign-based multinationals to shift debt into Canada from a country with lower tax rates. However, to get the two interest deductions—one in Canada and one in a foreign jurisdiction—the investment and related jobs must be located outside Canada.

11.66 The Canada Customs and Revenue Agency is pursuing a number of cases involving foreign-owned Canadian corporations that borrowed money and invested it in a newly created corporation in a tax haven, (which is often Barbados). The tax haven corporation then lent the funds to another non-resident corporation in the group. In 12 of these cases the foreign-owned corporations put a total of $1.1 billion of debt in their Canadian subsidiaries to finance foreign investments. As the Canadian subsidiaries deduct the interest charges from their taxable income, the interest expense on the debt reduces Canadian tax revenues.

Debt shifting by foreign-controlled corporations resulted in reduced tax revenue

11.67 The 1997 report of the Minister of Finance's Technical Committee on Business Taxation noted that there had been a tendency for foreign-controlled multinational businesses with Canadian subsidiaries to shift debt financing and the associated interest expense into Canada. It stated that the current rules had resulted in a major decrease in Canadian tax revenues. Research done for the Technical Committee estimated that this tax revenue shortfall was $3.5 billion in 1994, the last year for which data were available to researchers.

11.68 This tax revenue shortfall results from interest charges on the debt of foreign-controlled Canadian corporations to finance their investments both in Canada and in third countries. The research done for the Technical Committee did not quantify the portion of the tax revenue shortfall related to financing investments in third countries.

11.69 We observed that in three transactions foreign-owned Canadian corporations incurred $2.1 billion in debt to finance investments in third countries (Exhibit 11.4). In addition, the Canada Customs and Revenue Agency is pursuing cases where foreign-owned corporations put over $1.1 billion in debt in their Canadian subsidiaries to finance foreign investments (paragraph 11.66).

11.70 **Our review indicated that the tax revenue shortfall that results from interest charges on the debt of foreign-controlled Canadian corporations to finance investments in third countries would amount to hundreds of millions of dollars over the last 10 years.**

Exhibit 11.4 Shifting debt into Canada

Examples of how the Canadian tax system financed a non-resident's foreign operations

In each of these examples, the Canadian company may never pay tax on the income earned from its offshore investments because of the current rules.

- A United States company loaned its Canadian subsidiary about $1 billion. The Canadian subsidiary then invested the funds in a foreign company. The interest that the Canadian company paid on the $1 billion loan reduced Canadian tax revenues because it is deducted from the Canadian company's Canadian income before taxes.
- Canadian company A, a subsidiary of a U.S. company, borrowed $300 million. The $300 million plus $100 million of cash it already had, were invested in $400 million of shares of Canadian company B. "B" then invested the $400 million in shares of a Bermuda company. The interest which "A" paid on the loan reduced Canadian tax revenues because it is deducted from its Canadian income before taxes. Furthermore, if the cash amount of $100 million had stayed in Canada, the interest income which "A" would have earned would have been taxed in Canada.
- A foreign-owned Canadian company borrowed over $[illegible] million to invest in a Barbados subsidiary. The related interest expense of $[illegible] million reduced Canadian tax revenues because it is deducted from the Canadian company's Canadian income before taxes.

11.71 [illegible]

Court decision hampers the Canada Customs and Revenue Agency's ability to challenge certain financing arrangements

11.72 [illegible]

- [illegible]
- [illegible]
- [illegible]

11.73 [illegible]

Legislation was recently amended

11.74 Legislative amendments [illegible] ability of foreign-owned [illegible] foreign operations that [illegible] Canadian subsidiaries. However, there is still an incentive [illegible]

Exhibit 11.4 Shifting debt into Canada

Examples of how the Canadian tax system financed a non-resident's foreign operations

In each of these examples, the Canadian company may never pay tax on the income earned from its offshore investments because of the current rules.

- A United States company loaned its Canadian subsidiary about $1 billion. The Canadian subsidiary then invested the funds in a foreign company. The interest that the Canadian company paid on the $1 billion loan reduced Canadian tax revenues because it is deducted from the Canadian company's Canadian income before taxes.
- Canadian company A, a subsidiary of a U.S. company, borrowed $300 million. This $300 million plus $100 million of cash it already had, were invested in $400 million of shares of Canadian company B. "B" then invested the $400 million in shares of a Bermuda company. The interest which "A" paid on its loan reduced Canadian tax revenues because it is deducted from its Canadian income before taxes. Furthermore, if the cash amount of $100 million had stayed in Canada, the interest income which "A" would have earned, would have been taxed in Canada.
- A foreign-owned Canadian company borrowed over $800 million to invest in a Barbados subsidiary. The related interest expense of $100 million reduced Canadian tax revenues because it is deducted from the Canadian company's Canadian income before taxes.

Source: Canada Customs and Revenue Agency

11.71 The Technical Committee recommended that the *Income Tax Act* restrict the amount of interest expense that a Canadian corporation can deduct on borrowed funds related, directly or indirectly, to investments in foreign affiliates.

Court decision hampers the Canada Customs and Revenue Agency's ability to challenge certain financing arrangements

11.72 Until recently, the Agency did not allow taxpayers to claim an interest deduction on borrowed funds used to earn foreign source income through a foreign affiliate in limited circumstances. Some of the reasons it restricted this were because

- the overriding economic purpose of the loan was not to earn income,
- the taxpayer's primary purpose was to make a capital gain, or
- there was no possibility that the taxpayer would receive dividends that were more than the total cost of the interest.

11.73 As a result of a recent Supreme Court of Canada decision, the Agency can no longer challenge these types of arrangements.

Legislation was recently amended

11.74 Legislative amendments for tax years beginning after 1999 restrict the ability of foreign-owned multinationals to channel funds through Canada to foreign corporations that are not controlled foreign affiliates of their Canadian subsidiaries. However, there is still an incentive for Canadian subsidiaries of foreign-owned multinationals to borrow in Canada to finance offshore investments where the Canadian corporation has controlled foreign affiliates. A controlled foreign affiliate is one in which a corporation owns more than 50 percent of the voting shares.

Tax-free dividends from foreign affiliates

The concerns we had in 1992

11.75 We pointed out that the rules allow a Canadian corporation to receive tax-free dividends out of active business income earned by some of its foreign affiliates. The foreign affiliate had to be resident in one of the countries listed or designated in the Income Tax Regulations, and the active business income had to be earned there. The dividends paid by the foreign affiliate to the Canadian corporation were not subject to Canadian tax, on the basis that the underlying income was taxed by a foreign state at a rate similar to the Canadian rate.

11.76 We were concerned that a number of the designated countries had low tax rates or were tax havens. This would have allowed income from those countries to enter Canada tax-free even though that income had likely not been subject to tax at a rate similar to the Canadian rate.

11.77 Also, a foreign affiliate resident in a tax haven country, not designated in the Income Tax Regulations, could have been considered to be resident in a designated country through a technical rule. In this case, its dividends could be passed on to its Canadian affiliate without being subject to Canadian tax, even though the affiliate's income had not been subject to foreign tax at a rate similar to Canadian rates. For example, the technical rules allowed Canadian corporations to incorporate subsidiaries in tax havens such as Bermuda and Panama but have the central management and control of the corporation exercised in a treaty country such as the United States. Such a foreign affiliate could pass on dividends to a Canadian corporation on a tax-free basis, because it was assumed that the income was subject to tax in the treaty country. However, in reality neither the treaty country nor any other country taxed the income.

The Public Accounts Committee recommended a review of the rules

11.78 In its report of 23 April 1993, the Public Accounts Committee recommended that the Department of Finance assess the merits of being able to bring back to Canada all income from subsidiaries operating in tax havens on a tax-free basis. As noted in paragraphs 11.82 to 11.87 the legislative changes made in 1995 did not solve the problem. The 1997 report of the Minister of Finance's Technical Committee on Business Taxation examined the rules and recommended further changes to them.

The Technical Committee on Business Taxation found that tax arrangements erode the tax base

11.79 The Technical Committee noted that there is a rule that allows investment income to be re-characterized as active business income (this can arise through interaffiliate transactions). This rule encourages tax-planning mechanisms that erode Canada's tax base because dividends paid by foreign affiliates in designated countries from this re-characterized income (which may have been subjected to little or no tax) can then enter Canada tax-free (Exhibit 11.3).

11.80 The Technical Committee provided the following example. Canada has a tax treaty with Barbados, a country with a general corporate income tax rate of 40 percent. Special-status entities such as Barbados International Business Corporations, which are taxed in Barbados at preferential rates of 1 percent to 2.5 percent, can pass dividends on to Canada on a tax-free basis. This is equally true of certain tax-favoured entities in other treaty jurisdictions, which include Cyprus, Israel, Jamaica, and Luxembourg. Most typically, income earned by such entities occurs as a result of a double-dip financing structure, which was discussed earlier. For example, many financing structures involve a Canadian corporation borrowing in Canada to invest in a related finance company in a tax haven. In turn, the finance company lends the same capital to another foreign affiliate in a higher-tax jurisdiction.

11.81 The Technical Committee recommended that the government revise the rules and/or aggressively pursue a policy of renegotiating its existing treaties to prevent tax-privileged entities in treaty countries from enjoying the benefits of the rules that allow income from interaffiliate transactions to enter Canada tax-free. The treaties have not been renegotiated and changed.

Legislative amendments did not solve problem

11.82 **1995 general rule addresses the problem.** Under a general rule introduced in Canada in 1995, a dividend from a foreign affiliate could be received in Canada tax-free only if the foreign affiliate was resident in a designated treaty country both for purposes of Canadian law and for purposes of the treaty between Canada and that country. Under Canadian law a corporation is resident in a country if its central mind, management, and control are located in that country.

11.83 The explanatory notes to this 1995 general rule state that the change is a "simple means for **eliminating double taxation** on foreign business income earned by a foreign affiliate" [emphasis added]. In other words, Canada will not tax dividends received by a Canadian corporation from a foreign affiliate if that income was taxed by a foreign state.

11.84 For example, the Canada–Barbados tax treaty excludes Barbados International Business Corporations that are taxed at a very low rate from enjoying the benefits of the treaty. As a result, under the general rule dividends received from these corporations would be subject to tax in Canada.

11.85 This general rule also does not allow dividends from corporations that are flow-through or transparent entities to enjoy tax-free dividend treatment. Flow-through or transparent entities are ones whose owners pay tax on the income earned by the entity, rather than the entity paying the tax. As a result, dividends paid from income that is not taxed in another country would not enjoy tax-free treatment on entering Canada.

11.86 Two special rules provide exceptions to the 1995 general rule. Two special rules were also introduced in 1995 that provide exceptions to the general rule. One allows dividends from Barbados International Business Corporations and other similar corporations to qualify for tax-free treatment. This is exactly what was happening in 1992 when we raised our initial concerns.

11.87 The other special rule allows a Canadian corporation to establish a United States limited liability corporation (a flow-through entity) that is managed and controlled in the U.S. but carries on business activities outside the United States. Dividends from this type of entity, which may not be subject to tax in another country, can enjoy tax-free treatment on entering Canada. This is essentially what was happening before 1995 and what the 1995 general rule was designed to stop.

11.88 This means dividends from, for example, Barbados International Business Corporations can qualify for tax-free treatment in Canada. However, dividends from foreign affiliates that are resident in countries with which Canada does not have a treaty, and that are subject to a significantly higher rate of tax than foreign affiliates in Barbados, do not enjoy the same tax-free treatment.

11.89 Barbados changed its law in response to the 1995 amendments. Canadian insurance corporations were concerned that as a result of the 1995 amendments, dividends from their Barbados subsidiaries would not continue to qualify for tax-free treatment. This was because corporations incorporated under the Barbados *Exempt Insurance Companies Act* were not liable for Barbados tax, but paid a $5,000 annual licence fee.

11.90 To get around the problem, the *Exempt Insurance Companies Act* was amended to provide that corporations incorporated in Barbados under the Act were deemed to be resident in Barbados and the $5,000 annual licence fee was converted to a tax. The new tax rate was set at 0 percent for the first 15 years, 2 percent on the first $250,000 of income for subsequent years, and 0 percent on any excess income. If tax is not payable in any year, the licence fee is payable.

11.91 Malta changed its tax rules to bypass our law. The Canada–Malta treaty, which came into force in 1987, contains an anti-avoidance provision denying offshore corporations of Malta the benefits of the treaty that would exempt them from Canadian tax on a capital gain. This is because offshore corporations are exempt from taxation in Malta and they should also not be exempt from Canadian tax on any capital gain on the sale of taxable Canadian property. The gain would be subject to a 33.33 percent Canadian withholding tax.

11.92 In 1994, subsequent to entering into the treaty with Canada, Malta changed its rules for offshore corporations. They became subject to tax at the full rate and became eligible for a tax refund on dividends they paid to their offshore shareholders. Therefore, offshore corporations of Malta can still be exempt from taxation in Malta. However, they are now claiming that because they are now subject to taxation in Malta, the anti-avoidance provision in the Canada–Malta treaty does not now apply to them.

11.93 The Canada Customs and Revenue Agency now considers Malta a tax haven for non-resident shareholders. Non-resident shareholders incorporate a corporation in Malta to hold and dispose of taxable Canadian property to avoid Canadian withholding tax. The Agency is challenging this type of arrangement. Millions of dollars of tax revenue are at risk.

11.94 **Administrative action cannot address the Department of Finance's concern.** In 1992, the Department of Finance advised us that where there is a concern that income earned by a foreign affiliate in a tax haven country is brought back to Canada tax-free, the arrangement should be challenged by the Canada Customs and Revenue Agency on the basis of either the specific rules in the *Income Tax Act* or the general anti-avoidance rule.

11.95 However, in addition to Barbados, other countries that are designated treaty countries can be used effectively to earn income that is exempt from tax or taxed at a low rate. For example, Belgium, Cyprus, Hungary, Ireland, Luxembourg, Malta, the Netherlands, and Switzerland are all designated treaty countries. But these countries have aspects of their tax systems that provide preferential rates of tax for certain types of income or entities. This allows Canadian corporations to continue to receive dividend income from these countries, on a tax-free basis even though that income was either not subject to tax, or was taxed at a very low rate.

11.96 **An indication of the magnitude of the problem.** Although Canada amended its rules in 1995, little has changed. Tax havens continue to attract Canadian money. For example, Statistics Canada reports that Canadian direct investment in Barbados has increased from $628 million in 1988 to $23.3 billion in 2001—over a 3,600 percent increase. Exhibit 11.5 shows information on Canadian direct investment abroad for 2001 and 1990.

11.97 Information provided to us by the Canada Customs and Revenue Agency shows that in 2000, Canadian corporations received $1.5 billion in dividends from corporations in Barbados. Income defined as active business income and earned in Barbados can enter Canada tax-free. Although this income is not taxed in Canada, when it is paid to Canadian individual shareholders they receive federal and provincial dividend tax credits on it.

11.98 To determine the extent of Canadian involvement in Barbados International Business Corporations, the Canada Customs and Revenue Agency obtained information from Barbados. The Agency identified 3,500 Barbados International Business Corporations. Of those 3,500 corporations, 1,700 had Canadian directors. Exhibit 11.6 provides examples of how capital gains were moved out of Canada to Barbados.

Exhibit 11.5 Canadian direct investment abroad

Top 10 countries for investment in 2001	Invested in 2001 ($billions)	Invested in 1990 ($billions)	Increase (percentage)
United States	198.4	60.0	231
United Kingdom	38.3	13.5	184
Barbados	*23.3*	*1.5*	*1,453*
Netherlands	*10.9*	*1.5*	*627*
Bahamas	*7.9*	*2.0*	*295*
Bermuda	*7.5*	*1.8*	*317*
Ireland	*7.4*	*1.3*	*469*
Japan	6.4	0.9	611
Chile	5.6	0.3	1,767
Brazil	5.6	1.7	229
Total amount invested in all other countries	87.1	13.9	527
Total amount invested abroad for all countries	398.4	98.4	305

Note: Countries in italics are often referred to as tax havens. Certain dividends from Barbados, the Netherlands, and Ireland can enter Canada tax-free.

Source: Statistics Canada

Exhibit 11.6 Tax planning mechanisms continue to erode Canadian tax revenues

Moving capital gains to Barbados

- A Canadian subsidiary of a multinational foreign corporation owns shares in a foreign subsidiary that costs $1 billion and are worth $1.5 billion. The shares of the foreign subsidiary were transferred on a tax-free basis from the Canadian subsidiary to its Barbados subsidiary so that the tax cost of the shares to the Barbados subsidiary was $1 billion. The Barbados subsidiary then resold the shares for $1.5 billion to another Barbados subsidiary and realized a $500 million gain, but paid no tax on it. The $500 million capital gain moved from Canada to Barbados tax-free.

  The $1.5 billion was then loaned to a related Netherlands company. The Netherlands company paid interest of $100 million to $200 million a year on the loan. The interest was subject to Barbados income tax at 1 to 2 percent. The Barbados subsidiary paid dividends to the Canadian company that are tax-exempt in Canada. The Canadian company reinvested the funds in the Barbados subsidiary.

- A non-resident owned property that the Canada Customs and Revenue Agency determined was taxable Canadian property. If the property is sold it would result in a $750 million capital gain that would be subject to tax in Canada. The non-resident became a resident of Barbados. The property was sold but the gain may be exempt from Canadian tax under the Canada-Barbados tax treaty. The gain was not subject to tax in any other country. The Agency has been reviewing this transaction for over a year.

Source: Canada Customs and Revenue Agency

Exhibit 11.5 Canadian direct investment abroad

Top 10 countries for investment in 2001	Invested in 2001 ($billions)	Invested in 1990 ($billions)	Increase (percentage)
United States	198.4	60.0	231
United Kingdom	38.3	13.5	184
Barbados	23.3	1.5	1,453
Netherlands	10.9	1.5	627
Bahamas	7.9	2.0	295
Bermuda	7.5	1.8	317
Ireland	7.4	1.3	469
Japan	6.4	0.9	611
Chile	5.6	0.3	1,767
Brazil	5.6	1.7	229
Total amount invested in all other countries	87.1	13.9	527
Total amount invested abroad for all countries	398.4	98.4	305

Exhibit 11.6 Tax planning mechanisms continue to erode Canadian tax revenues

Moving capital gains to Barbados

- A Canadian subsidiary of a multinational foreign corporation owns shares in a foreign subsidiary that costs $1 billion and are worth $1.5 billion. The shares of the foreign subsidiary were transferred on a tax-free basis from the Canadian subsidiary to its Barbados subsidiary so that the tax cost of the shares to the Barbados subsidiary was $1 billion. The Barbados subsidiary then resold the shares for $1.5 billion to another Barbados subsidiary and realized a $500 million gain, but paid no tax on it. The $500 million capital gain moved from Canada to Barbados tax free.

  The $1.5 billion was then loaned to a related Netherlands company. The Netherlands company paid interest of $100 million to $200 million a year on the loan. The interest was subject to Barbados income tax at 1 to 2 percent. The Barbados subsidiary paid dividends to the Canadian company that are tax exempt in Canada. The Canadian company reinvested the funds in the Barbados subsidiary.

- A non-resident owned property that the Canada Customs and Revenue Agency determined was taxable Canadian property. If the property is sold it would result in a $750 million capital gain that would be subject to tax in Canada. The non-resident became a resident of Barbados. The property was sold but the gain may be exempt from Canadian tax under the Canada-Barbados tax treaty. The gain was not subject to tax in any other country. The Agency has been reviewing this transaction for over a year.

Taxable dividends from foreign affiliates

The concern we had in 1992

11.99 In 1992, Canada taxed dividends that a Canadian corporation received from foreign affiliates that were resident in a country not designated in the Income Tax Regulations. Canada also taxed dividends received from foreign affiliates resident in designated countries if the dividends were received from investment income rather than from active business sources. In addition, Canada allowed a tax credit to Canadian corporations for foreign taxes paid by the foreign affiliate or foreign taxes withheld from the dividend. In situations where the foreign affiliate's income was taxed at a lower rate than Canadian tax rates, Canadian foreign affiliates often deferred the distribution of dividends to avoid paying Canadian taxes.

11.100 We were concerned that a number of schemes had been devised to get this type of income into Canada on a tax-free basis. For example, it is possible to repatriate funds to Canada in ways other than through the payment of dividends.

Legislative changes did not solve the problem

11.101 Although the rules were modified in 1995 it is still possible for a foreign affiliate to simply loan funds to its Canadian parent rather than pay a dividend that would be subject to Canadian tax.

Foreign accrual property income

The concern we had in 1992

11.102 The foreign accrual property income rules that deal with passive income such as interest are a key anti-avoidance element of the current system. The rules are intended to discourage Canadian residents from shifting investment income, such as interest, to controlled foreign corporations. This is done by taxing the Canadian shareholders on the investment income of the controlled foreign affiliate as it is earned, rather than waiting for it to be paid to them in the form of a dividend.

11.103 A key concern we had in 1992 was that the *Income Tax Act* did not define active or passive income in the context of the foreign accrual property income rules.

The Public Accounts Committee asked for the rules to be tightened

11.104 The Public Accounts Committee recommended that the law be amended to

- clarify what constitutes active business income,
- prevent Canadian corporations from importing the tax losses of their foreign subsidiaries into Canada, and
- ensure that the rules protect the integrity of Canada's tax base.

Legislation was amended

11.105 These rules were amended in 1995. "Active business" was defined and the rules were changed to prevent Canadian corporations from writing-off the tax losses of their foreign subsidiaries against Canadian income.

11.106 Certain businesses are exempt from the foreign accrual property income rules if they have more than five full-time employees. The qualifying businesses are financial institutions, trading or dealing in securities or commodities, real estate development, lending money or licensing property, and the insurance or reinsurance of risks.

The Technical Committee on Business Taxation recommended tightening the rules

11.107 As previously noted (paragraph 11.81), the Technical Committee recommended in 1997 that the government tighten even further the investment income rules and/or aggressively pursue a policy of renegotiating the provisions of its existing treaties that allow investment income (that can arise through interaffiliate transactions) to enter Canada on a tax-free basis.

The rules are still being exploited

11.108 As recommended by the Public Accounts Committee, the rules were amended to protect the integrity of Canada's tax base. However, a number of problems still exist, including the following:

- The rule requiring five full-time employees, which can exempt a corporation from the foreign accrual property income rules, is difficult to administer. In testimony before the Public Accounts Committee, an official of the Department of Finance stated that it would be inappropriate to apply the five full-time employee test for purposes of the foreign accrual property income rules, because it would enable some income that should clearly be categorized as investment income to be easily reclassified as active business income.

  The five full-time employee rule favours large multinational corporations for which the cost of six full-time employees may be insignificant compared to the tax benefits gained by avoiding the foreign accrual property income rules. Moreover, it is difficult to determine which corporations qualify under this rule, or which do not. It is difficult to determine if employees are employed actively in the business. The standard for full-time employment is low; one case held that four hours per day was sufficient. Also, the law permits partnerships and other arrangements to be used to satisfy the five full-time employee requirement.

- Taxpayers are joining together to establish tax haven corporations. Each taxpayer could own less than 10 percent of the tax haven corporation to avoid the rules that deal with the reinsurance of Canadian risks. The effect of this scheme is to divert income that should have been taxed in Canada to a tax haven corporation. The Agency is presently reviewing a scheme involving 400 Canadian businesses involved in moving income to the Cayman Islands and Barbados. Insurance corporations were created in those tax havens to reinsure Canadian risks, to contravene the intent of the foreign accrual property income rules.

- Large multinational corporations have structured their international operations to avoid paying tax on investment income earned offshore. This is done by having a Canadian corporation in the group own 50 percent of the voting shares of the foreign corporation. The foreign corporation is not a controlled foreign affiliate because control requires the ownership of more than 50 percent of the voting shares. The foreign accrual property income rules are avoided because only controlled foreign affiliates are subject to them.
- The law does not contain detailed rules with respect to relationships between corporations, trusts, and partnerships to prevent taxpayers from splitting ownership among related or non-arm's length parties. In these circumstances it is a question of fact whether or not a trust or partnership is dealing at arm's length with a corporation. If the trust or partnership is dealing at arm's length with a corporation, the foreign accrual property income rules may not apply.
- A controlled foreign affiliate of a Canadian corporation can earn business income that avoids the foreign accrual property income rules even though the affiliate receives substantial assistance from its parent in earning the income. For example, a controlled foreign affiliate can carry on an active business outside Canada and enter into a management contract with its Canadian parent to manage the business. If the business is carried on directly by the Canadian corporation, it would be subject to Canadian tax. However, because the Canadian corporation is carrying on the business indirectly rather than directly, it is not subject to Canadian tax.
- The investment income rules are intended to prevent a Canadian corporation from setting up an offshore insurance corporation, which it controls, to insure its Canadian risks. Since the premium paid in respect of the risk is deductible in computing Canadian taxable income, this leads to an erosion of Canadian tax revenues—income is being shifted to a related offshore insurance corporation. Corporations, such as financial institutions, are avoiding the rules by exchanging comparable risk portfolios with foreign insurers.

11.109 Although changes have been made to the rules, the foreign accrual property income rules continue to be exploited, which puts tax revenues at risk.

Conclusion

11.110 Ten years have passed since we first expressed concern that tax arrangements for foreign affiliates cost hundreds of millions of dollars in reduced tax revenues. In response to our Report, the House of Commons Standing Committee on Public Accounts held hearings and made recommendations to the Department of Finance in 1993. The Minister of Finance's Technical Committee on Business Taxation also examined the issues and reported on them 1997.

11.111 We observed that in the three transactions shown in Exhibit 11.4, foreign-owned Canadian companies incurred $2.1 billion of debt to finance investments in third countries. In addition, the Canada Customs and Revenue Agency is pursuing a number of cases involving foreign-owned Canadian companies that borrowed money to finance foreign investments. Twelve of these case involved $1.1 billion of debt. The Minister of Finance's Technical Committee on Business Taxation also noted that Canada's rules have allowed foreign-owned multinational businesses to shift debt into Canada and have encouraged tax-planning mechanisms that erode Canadian tax revenues.

11.112 We also observed that in a transaction shown in Exhibit 11.6, a foreign affiliate of a foreign-owned Canadian corporation was used to move $500 million of capital gains from Canada to Barbados tax-free. Information provided to us by the Canada Customs and Revenue Agency shows that in 2000, Canadian companies received $1.5 billion of virtually tax-free dividend income from their affiliates in Barbados (compared with $400 million in 1990). In paragraph 11.108 we showed how the foreign accrual property income rules continue to be exploited.

11.113 In our view, tax arrangements for foreign affiliates have eroded Canadian tax revenues of hundreds of millions of dollars over the last 10 years.

11.114 **Recommendation.** To protect the integrity of the tax base, the Department of Finance should obtain and analyze current information to reassess the tax revenue impact and the rationale of

- allowing foreign-owned Canadian corporations to deduct interest on borrowed funds related directly or indirectly to investments in foreign affiliates, and
- allowing tax-privileged entities in treaty countries to bring income into Canada tax-free.

11.115 **Recommendation.** The Department of Finance should reassess the rules related to foreign accrual property income and taxable dividends in order to protect the integrity of the tax base.

Department's response: The Auditor General, in her December 2002 Report, expresses a number of observations with respect to Canada's system of taxation of foreign source income and foreign affiliates. These observations, which follow similar observations made in the Auditor General's 1992 Report, are of two types. First, the Auditor General raises issues regarding the policy underlying some of the most significant aspects of the current system. Second, the Auditor General expresses concerns that certain tax arrangements entered into by Canadian taxpayers may contravene the policy intention of the current system.

With respect to the policy issues raised regarding Canada's system for taxing foreign source income and foreign affiliates, the Department expressed the general view in response to the 1992 Report that "the existing foreign affiliate regime accurately reflects the policy intention of Parliament and provides for the taxation of all income that is intended to be subject to Canadian income tax." Since 1992, the government has enacted several amendments to the law, which specifically address a number of issues raised by the 1992 Report of the Auditor General. In particular, these amendments have strengthened and clarified the foreign accrual property income or FAPI rules, which prevent the use of controlled foreign affiliates to avoid Canadian tax. In broad terms, the current Canadian income tax system provides for the exemption of certain types of foreign source income from taxation, the deferral of taxation for other types of foreign source income until repatriated to Canada, and the taxation on an accrual basis of certain passive foreign source income whether repatriated or not. This system is complex and necessarily involves making distinctions in the definition of the different types of income and their respective tax treatment. As a result, the system is continually under review by the Department in order to ensure that it continues to achieve a reasonable balance of policy objectives.

It is also important to note that there is an interaction between this system of taxation of foreign source income and the taxation of Canadian source income. The government has made significant changes to the general structure of the income tax system since 1992 that are relevant to issues raised by the Auditor General, but that are not referred to in this chapter. In particular, the government has implemented a five-year tax reduction plan that will significantly lower the federal corporate statutory income tax rate. Also, a number of provinces are making significant reductions in provincial corporate income tax rates. The net result of these changes will be that Canada will have on average a five percentage-point lower corporate tax rate (including capital taxes) than the United States by 2006.

This significant reduction of corporate tax rates will change the tax effects of placing debt financing in Canada. This is a reversal of the situation underlying the studies referred to in this chapter. As a result of this change, Canada will become a relatively less attractive jurisdiction for multinationals to locate their debt financing and interest expenses.

With respect to specific tax arrangements entered into by Canadian taxpayers as discussed in this chapter, it is important to note that the use by taxpayers of international tax arrangements evolves with changing circumstances and is thus the subject of continuous monitoring by both the Department and the Canada Customs and Revenue Agency. When specific issues are identified, analysis is performed and amendments are recommended in order to curtail abuse of the law and its intent. This process usually involves consultation with interested stakeholders. This helps to ensure that such amendments are properly targeted, sustainable over time, in keeping with international norms, and not inappropriately detrimental to the international competitiveness of Canadian multinationals.

As a result of this process, several amendments to Canada's *Income Tax Act* have been implemented since 1992 that strengthen the existing anti-avoidance measures in the legislation or provide new legislative tools to challenge abusive arrangements. As noted in this chapter, the FAPI rules, which deal with the shifting of passive income to foreign jurisdictions by Canadian residents, were the subject of substantial modifications in 1995 and have continued to be reviewed and improved since that time. The effect of these changes to the legislation has been to make the FAPI rules more effective in protecting the Canadian tax base by more precisely defining passive income that is subject to Canadian taxation as it is earned, active business income that may be subject to taxation on its repatriation to Canada by way of dividends paid to Canadian residents, and the situations under which such passive income arises. As also noted in this chapter, Canada's *Income Tax Act* has recently been amended in order to restrict the inappropriate channelling of funds through Canadian subsidiaries to third countries. The effect of these modifications to the legislation has been to make these rules more effective by ensuring that they apply in cases where funds are transferred to subsidiaries in third countries through the use of back-to-back transfer arrangements and the use of special types of entities such as partnerships and trusts.

Furthermore, the government has taken action in four areas that, although not noted in this chapter, are important in reducing the detrimental impact on the Canadian tax base of tax arrangements using tax havens. First, new foreign reporting requirements were implemented in 1996 requiring Canadian taxpayers to provide detailed information regarding their foreign sources of income and their use of foreign entities in earning such income. These new reporting requirements have already provided the Canada Customs and Revenue Agency with important information in relation to non-resident trusts, foreign affiliates, and FAPI. The Canada Customs and Revenue Agency has indicated that this information has improved its ability to manage compliance by allowing it to scrutinize substantial foreign investments held by Canadian taxpayers.

Second, improved transfer-pricing rules were enacted in 1997 to counter the potential for cross-border shifting of income through the manipulation of transfer prices in transactions between related companies. Transfer-pricing provisions of the income tax system are of increasing importance in a world where corporate tax planning strategies also have become globalized. As a result of these changes, Canada's transfer-pricing legislation is fully in line with international standards and helps ensure that an appropriate amount of profit is reported and taxed in Canada.

Third, revised proposals first included in the 1999 federal budget would, if implemented by Parliament, strengthen the rules applicable with respect to non-resident trusts and foreign investment entities in which Canadian residents have an interest. The proposed modifications to these rules, the details of which were set out in draft legislation released on 11 October 2002, are intended to make the income tax system fairer and prevent tax avoidance by taxpayers that invest in or otherwise transfer property to foreign trusts or investment funds. These provisions support the FAPI system and better protect the tax base by ensuring that passive income earned outside of Canada by Canadian residents is taxed in Canada as earned.

Fourth, the Department also participates actively in the work of the Organisation for Economic Co-operation and Development (OECD) to enhance co-operation with other jurisdictions to secure the integrity of our respective tax systems. For example, the OECD reviews and updates on an ongoing basis its Model Tax Convention (which Canada uses as a model to negotiate its own bilateral tax treaties) and its Transfer Pricing Guidelines (which define the standards used for calculating an appropriate amount of income in each jurisdiction in respect of cross-border related-party transactions). The OECD also has a project ongoing that is intended to address some of the issues raised by harmful tax practices with respect to mobile activities that erode tax bases of other countries and distort the location of capital and services.

With respect to the recommendations made in this chapter, the Department of Finance will continue to assess the rationale and operation (including revenue impact) of Canada's system for taxing foreign affiliates and foreign source income, as well as the treatment of expenses incurred to make investments in those affiliates. This analysis will incorporate the most recent information available for this purpose. As part of this process, the Department of Finance will continue to consider appropriate improvements to Canada's system of taxation of foreign source income and foreign affiliates, recognizing that the system serves a number of policy goals, including supporting the international competitiveness of Canadian businesses.

Audit team

Assistant Auditor General: Douglas Timmins
Principal: Barry Elkin
Directors: Denis Labelle and Brenda Siegel

Related audit work

See also Chapter 4, Canada Customs and Revenue Agency: Taxing International Transactions of Canadian Residents.

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Parc Downsview Park Inc.

An urban park is being created without formal approval by Parliament

In brief

For the past two years, we have reported that the Government of Canada has not requested—and accordingly Parliament has not provided—clear and explicit authority for the creation and operation of an urban park being undertaken by Parc Downsview Park Inc. (Downsview Park). Furthermore, Parliament has not authorized the related spending of public funds, estimated to be more than $100 million over the next 20 years.

We also reported that public funds were transferred to Downsview Park without formal approval by Parliament. We concluded that the government should remedy the situation so that the role of Parliament is fully respected.

In the current year we noted that the government has not taken steps yet to correct the situation.

The House of Commons Standing Committee on Public Accounts held a hearing on this issue in April 2002, which was continued in June 2002. Because of the importance of the matter, the Committee adopted a motion to request the Auditor General to continue to advise Parliament and the Committee on Downsview Park.

Background

11.116 Downsview Park was established following the closure of Canadian Forces Base Toronto, which was announced in the government's 1994 Budget. The only reference to Downsview Park was contained in the National Defence budget impact paper referred to in the 1994 Budget, which indicated that "[the] Downsview site will be held in perpetuity and in trust primarily as a unique urban recreational green space for the enjoyment of future generations."

11.117 In April 1997, the government issued an order-in-council authorizing Canada Lands Company Limited (Canada Lands) to set up a subsidiary corporation to develop an urban park. Canada Lands incorporated Downsview Park as a wholly owned subsidiary Crown corporation in July 1998. Members of the board of directors were officially appointed in February 1999 and Downsview Park began operations in April 1999.

11.118 Generally, when a new Crown corporation is established, it receives a mandate from Parliament through legislation establishing a parent Crown corporation. The government chose to set up Downsview Park as a subsidiary of Canada Lands. It then required only an order-in-council to authorize the incorporation of Downsview Park. As we noted in our last two years' reports, except for the payment of $2 million as described below, the government, including Canada Lands, met all applicable administrative and legal requirements in establishing Downsview Park. However, the individual steps taken together had the effect of leaving Parliament out of the decision-making process. The mandate of Downsview Park was not presented to Parliament for review and approval.

11.119 In addition to our concern about the method by which this urban park was created, we reported specific transactions that took place without formal approval by Parliament. Details are as follows:

- In 2000, National Defence paid $2 million to Downsview Park for expenditures related to the development of the park site. In our view, these expenditures were not a valid charge against National Defence's Vote 1, which Parliament had authorized to be used for the Department's operating expenditures.
- In 2001, the Government of Canada undertook a significant transaction whose effect was an infusion of approximately $19 million in cash to Downsview Park for its program activities. We concluded that given the importance of this project and the nature of the transactions, formal approval by Parliament would have been preferable.
- During 2002, Downsview Park used about $4 million, and about $1 million in 2001, from the proceeds of $19 million to fund its operating and capital expenses. At 31 March 2002, the unused balance was approximately $14 million.

11.120 As we have noted in our previous reports, if the government wishes to set up an urban park and invest more than $100 million of public funds in it over the next 20 years, it should have clear and explicit approval from Parliament to do so.

11.121 In addition, it appears that the full consequences of the current corporate structure were not thought out fully when Downsview Park was created. The result is that Downsview Park is facing severe difficulties in carrying out its mandate. For example, as mentioned in our audit observation in 2000, the particular structure used to create the new park was based on the assumption that Downsview Park would be eligible to receive charitable donations and use them to develop the park. Canada Lands was authorized to incorporate Downsview Park Foundation that would solicit charitable donations. Under the *Income Tax Act*, however, the foundation could donate its funds only to a "qualified donee." Downsview Park is not a "qualified donee" for income tax purposes because it was established as a taxable, commercial, for-profit entity. We understand that the current corporate structure has been reviewed by Downsview Park and Canada Lands and recommendations have been made to the government.

11.122 As well, Downsview Park has been working with National Defence, which owns the property, to obtain a long-term land lease to the Downsview lands. This major issue must also be resolved in order for Downsview Park to complete commercial transactions, which are vital to the self-financing mandate of the Corporation.

Issue

11.123 The government has still taken no steps to obtain Parliament's authorization to set up an urban park or to rectify the weaknesses in the structure that have proven to be impediments in implementing the Corporation's objectives and plans.

11.124 We pursued our discussions with corporate management and government officials during the year.

11.125 As mentioned earlier, the House of Commons Standing Committee on Public Accounts held a hearing on this issue in April 2002, which was continued in June 2002. The Committee voted a motion asking the Auditor General to continue to advise Parliament and the Committee on Downsview Park, or any other similar programs, at the discretion of the Auditor General.

Conclusion

11.126 We believe that the information that was provided in the 1994 Budget about the creation of an urban park was not sufficient for Parliament to fully exercise its oversight over the spending of public funds.

11.127 There is a pressing need for the government to finalize its review of the current corporate structure and to remedy the situation so that the role of Parliament is fully respected and Downsview Park is able to carry out its mandate effectively.

11.128 **Recommendation.** The government should urgently take steps to rectify the shortcomings in the structure of Parc Downsview Park Inc. and obtain Parliament's clear and explicit authority for the creation and operation of an urban park being undertaken by Downsview Park.

Government's response. Canada Lands Company Limited and Parc Downsview Park Inc. have taken note of the Auditor General's position regarding the need to involve Parliament in the creation and operation of Downsview Park. We wish to reiterate that, as mentioned by the Auditor General, Canada Lands met all applicable administrative and legal requirements in establishing Parc Downsview Park Inc. We also recognize that the current structure of Downsview Park should be revisited in order to allow it to fully achieve its mandate. Discussions with the government are currently under way to review the situation.

The Department of Transport, responsible for providing independent policy advice to the Minister as Minister responsible for several Crown corporations that include Canada Lands Company Limited and Parc Downsview Park Inc., has noted the observations of the Auditor General with respect to Downsview Park Inc.'s corporate structure and will pursue discussions with central agencies in this regard.

Audit team

Assistant Auditor General: Shahid Minto
Principal: Alain Boucher
Director: Louise Bertrand

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Atomic Energy of Canada Limited

The government has approved Atomic Energy of Canada Limited's five-year corporate plan for the first time since 1994–95

In brief

The government has approved Atomic Energy of Canada Limited's five-year corporate plan for the first time since 1994–95. The Governor in Council's approval of the 2002–03 to 2006–07 corporate plan in July 2002 meant that the annual accountability requirements of the *Financial Administration Act* related to the corporate plan have now been met for 2002–03. Atomic Energy of Canada Limited and the government expended considerable effort to resolve this long-outstanding issue. The result of this agreement is that the auditors have removed the statement related to this issue from the auditors' report on Atomic Energy of Canada Limited's 2002 financial statements. This statement had been included in the auditors' reports since 1998.

While the approval of the five-year corporate plan is a significant achievement, we continue to urge Atomic Energy of Canada Limited and the government to work together to monitor and address some of the longer-term issues affecting the Corporation.

Background

11.129 As a result of its 1995 Program Review, the government reduced its annual appropriations to Atomic Energy of Canada Limited. The amount was reduced from $170 million in fiscal 1996–97 to $100 million two years later. The government also directed the Corporation to focus its research and commercial activities on the CANDU nuclear power reactor. We indicated in our December 1998 Report, that while the Program Review focussed on government funding for Atomic Energy of Canada Limited, other ongoing issues remained.

11.130 The five-year corporate plan for Crown corporations is the cornerstone of the control and accountability framework in the *Financial Administration Act*. Annual submission and approval of a good five-year corporate plan is necessary to demonstrate that

- the corporation has properly interpreted its mandate;
- the corporation's objectives, strategies, and targets are appropriate and aligned with government priorities;
- its performance objectives provide a strong basis for holding it to account and performance against past targets is reported;
- trade-offs the corporation has made between commercial and public policy objectives are reasonable; and
- there is a need to assess the continued relevance of the corporation's mandate.

11.131 This report describes developments since 1998, the long-term issues that remain, their implications for the Corporation, and the importance of those issues to Parliament.

Issues

Recent developments and long-term issues

11.132 We are pleased to report that the government has approved Atomic Energy of Canada Limited's five-year corporate plan for the first time since 1994–95. The Governor in Council's approval of the 2002–03 to 2006–07 corporate plan in July 2002 meant that the annual accountability requirements of the *Financial Administration Act* related to the corporate plan have now been met for 2002–03. Atomic Energy of Canada Limited and the government expended considerable effort to resolve this long-outstanding issue. The result of this agreement is that the auditors have removed the statement related to this issue from the auditors' report on Atomic Energy of Canada Limited's 2002 financial statements. This statement had been included in the auditors' reports since 1998.

11.133 The approved corporate plan sets out strategies and plans for the next five years. However, there are activities and projects beyond the five-year period that will require the investment of hundreds of millions of dollars over at least the next 100 years.

11.134 These projects and activities result from the need to clean up wastes and to support the safe functioning of existing applications. This includes the human knowledge and the equipment and facilities to sustain

- the safe and effective use of nuclear power, nuclear medicine, and nuclear technology for industrial and research purposes; and
- the obligations to manage waste products and to decommission facilities employed over the past 60 years in defence, isotope, and power reactor programs.

11.135 There is no consensus between the Corporation and the government on how best to manage these activities, or on which federal department or agency will be financially responsible for them beyond the five-year period. While Atomic Energy of Canada Limited's commercial activities will assist in funding these activities, it is by no means certain that its contribution will provide all of the funding required.

Conclusion

11.136 Atomic Energy of Canada Limited has made considerable progress in settling ongoing issues with the government since our December 1998 Report. As the Governor in Council approved its 2002–03 to 2006–07 corporate plan, the annual accountability requirements of the *Financial Administration Act* related to the corporate plan have now been met for 2002–03. While some work has been completed regarding the long-term direction for the Corporation, we continue to urge Atomic Energy of Canada Limited and the government to work together to monitor and address some of the long-term issues affecting the Corporation.

Audit team

Assistant Auditor General: John Wiersema
Principal: Crystal Pace

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Employment Insurance Account

No explanation was provided to Parliament for a surplus reaching $40 billion

In brief

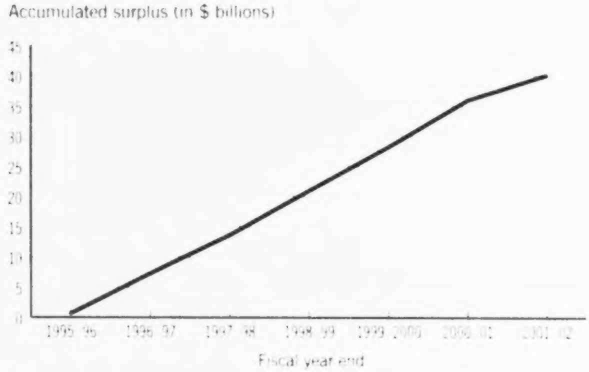
Since 1996, the Employment Insurance Account has collected more revenues than the expenditures it had to pay. These excess revenues are accumulated and shown in the surplus of the Account. The premium rates for 2001 and 2002 were set respectively by the Canada Employment Insurance Commission and by the Governor in Council. In our view, it was Parliament's intent that the Employment Insurance Program be run on a break-even basis over the course of a business cycle, while providing for relatively stable premium rates. However, the accumulated surplus of the Employment Insurance Account increased by about $4 billion in 2001–02 to $40 billion. Neither the Commission nor the government clarified and disclosed what constitutes an adequate level of accumulated surplus, the time required to reach that level, and the factors considered when setting the rates. Therefore, we are unable to conclude that the intent of the *Employment Insurance Act* has been observed in setting the premium rates. The government plans to review the rate-setting process before the 2004 rate is set.

Background

11.137 The Employment Insurance Account is a record of all revenues and expenditures relating to employment insurance programs. Revenues consist mainly of premiums collected from workers and their employers; expenditures include unemployment benefits paid out for job loss, parental leave, and other situations, and the cost of delivering them. It also includes employment benefits and support measures under part II of the *Employment Insurance Act*. An accumulated surplus or deficit in the account is the difference between employment insurance revenues and expenditures over time. Prior to 1996, the way the rate was set had the effect of limiting the amount of surpluses or deficits in the Unemployment Insurance Account, and of forcing premium rate increases or reductions within two to four years after the onset of a recovery or a recession. It also prevented premium rates from staying too low or too high for any extended period. In other words, the amount collected would equal revenues needed to cover program costs over a relatively short period of time. In 1996 this condition was changed to allow surpluses or deficits to accumulate over a longer period of time, provided that revenues covered costs over a business cycle. Since then, the account has been in surplus. The accumulated surplus has grown over the past six years from $666 million in March 1996 to $40 billion in March 2002 (Exhibit 11.7).

11.138 The Employment Insurance Account is consolidated with the financial statements of the Government of Canada. As a result, it has a significant impact on the government's overall financial results. For example, the government's overall surplus in 2001–02 of $10 billion would have been $4 billion lower were it not for the surplus in the Employment Insurance Account.

Exhibit 11.7 The growth of surplus amounts in the Employment Insurance Account



Source: Audited financial statements of the Employment Insurance Account

11.139 Since 1999, we have drawn Parliament's attention to our concerns about both the size and the growth of the accumulated surplus. During 2001–02, the accumulated surplus increased by an additional $4 billion to $40 billion. This is far higher than the maximum that the Chief Actuary of Human Resources Development Canada considered sufficient in his last report, which dealt with Employment Insurance premium rates for 2001. The Chief Actuary estimated that a reserve of $10 billion to $15 billion, attained just before an economic downturn, should be enough to meet the added costs of unemployment benefits. The 2002–03 *Report on Plans and Priorities* for Human Resources Development Canada indicated that the accumulated surplus of the Employment Insurance Account was expected to increase by another $2.3 billion during that fiscal year.

11.140 The House of Commons Standing Committee on Public Accounts recommended in February 2000 that the government disclose to Parliament all the factors used to set the employment insurance premium rates and to determine the appropriate level of the reserve for the Employment Insurance Account. In its response, the government indicated that it would examine the recommendations made previously by the House of Commons Standing Committee on Finance on the subject. The Standing Committee on Human Resources Development and the Status of Persons with Disabilities recommended in May 2001 that it be part of the upcoming review of the process used to set premium rates. The Committee also suggested particular examination areas to be included in the review. The government has not issued any formal response at this time.

Issues

Neither the Commission nor the government clarified or disclosed key factors in setting the employment insurance premium rates.

11.141 Clear goals for government activities is one of the cornerstones of good management practice and accountability to Parliament. This is a key message in the overall management framework that the government set out for itself in its 2000 policy statement, *Results for Canadians: A Management Framework* *for the Government of Canada.* In broad terms, the government defines and acts on its goals within the direction and authority that Parliament provides in legislation. It then reports back to Parliament on its performance in meeting those goals and Parliament can hold the government to account. The government's intent is to apply results-based management to all its major activities, functions, services, and programs.

11.142 Administering the revenues and expenditures of the Employment Insurance Account is a significant activity of the federal government. In 2001–02, $19 billion flowed into the account from contributors and $15 billion was spent on benefits and administration. The financial statements of the Employment Insurance Account cover its fiscal year, which runs from the beginning of April to the end of March. Under the *Employment Insurance Act*, the rates for employment insurance premiums are set on a calendar-year basis. As a result, in the fiscal year 2001–02 there were two premiums rates—one for the last nine months of 2001 and another for the first three months of 2002.

11.143 The Canada Employment Insurance Commission set the 2001 premium rate pursuant to section 66 of the Act. This section required that the rate, to the extent possible, ensure that there will be enough revenue over a business cycle to pay the amounts authorized to be charged to the account, while maintaining relatively stable rates. In our view, this meant that employment insurance premiums would equal expenditures over some period of time, including a reserve sufficient to maintain rate stability in an economic downturn. In other words, we believe Parliament's intent was that this program would be run on a break-even basis over the course of a business cycle, while providing for relatively stable rates. The legislation also meant that the Commission had to make certain key decisions—such as how it would apply the ideas of a "business cycle" and "relatively stable rates."

11.144 In May 2001, the Act was amended to suspend section 66, and give the Governor in Council, on the recommendation of the ministers of Human Resource Development Canada and of Finance, the authority to set rates for 2002 and 2003. While section 66 is suspended, the Act provides no criteria to the Governor in Council on how to set the rates. Nevertheless, section 66 comes back into force in 2004. At that time, in our view it is Parliament's intent that the program should be run on a break-even basis again.

11.145 In the interests of accountability, and given Parliament's apparent intent, both past and future, we expected that the Commission and the government would have clarified and disclosed the factors considered in setting the premium rates for 2001 and 2002, the target level for the accumulated surplus, and the time required to reach that level. However, we found that neither the Commission nor the government have done so. As a result, we cannot conclude that the setting of premium rates for 2001 and 2002 observed the intent of the Act.

Status of the government review of the rate-setting process

11.146 When section 66 was suspended, the government announced that it would review the process for setting premium rates. In our view, the review should result in a process that is transparent and objective. In particular, the way that the government interprets the Act needs to be made clear so that Parliament can be assured that its intent is being followed.

11.147 Officials from the Department of Finance have advised us that internal research on the process for setting premium rates is continuing, but that no public consultations have taken place as yet. Much needs to be done before section 66 comes back into force in 2004, and the Canada Employment Insurance Commission must set the 2004 premium rate in the fall of 2003. The government should consider many questions in its review, such as the following:

- What constitutes an adequate reserve and how much time is required to reach that level?
- What are the impacts on premium payers and on the purposes and intent of the Employment Insurance Program in the short and long terms, where the Account balance exceeds the maximum reserve considered sufficient by the Chief Actuary of Human Resources Development Canada?

In view of the growing size of the accumulated surplus, we urge the government to take all the necessary steps to clarify the rate-setting process and to make the process more open and transparent.

Conclusion

11.148 In our view, it was Parliament's intent that the Employment Insurance Program be run on a break-even basis over the course of a business cycle, while providing for relatively stable premium rates. However, the accumulated surplus of the Employment Insurance Account increased by another $4 billion to $40 billion in 2001–02. Neither the Commission nor the government clarified and disclosed what constitutes an adequate level of accumulated surplus, the time required to reach that level, and the factors considered in setting the rate. Therefore, we are unable to conclude that the intent of the *Employment Insurance Act* has been observed in setting the premium rates for 2001 and 2002.

Audit team

Assistant Auditor General: Maria Barrados
Principal: Peter Simeoni

For information, please contact Communications at (613) 995-3708
or 1-888-761-5953 (toll-free).

Appendices

Table of Contents

Appendices

A. *Auditor General Act* 1

B. *Financial Administration Act* 7

C. Reports of the Standing Committee on Public Accounts to the House of Commons, 2001–02 14

D. Report on the audit of the President of the Treasury Board's report to Parliament 15

E. Costs of Crown corporation audits conducted by the Office of the Auditor General of Canada 16

Appendix A *Auditor General Act*

R.S.C., c. A-17
An Act respecting the Office of the Auditor General of Canada and sustainable development monitoring and reporting
1995, c. 43, s.1.

Short Title

Short title

1. This Act may be cited as the *Auditor General Act*. 1976-77, c. 34, s.1.

Interpretation

Definitions

2. In this Act,

"appropriate Minister"

"appropriate Minister" has the meaning assigned by section 2 of the *Financial Administration Act*;

"Auditor General"

"Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);

"category I department"

"category I department" means

(a) any department named in Schedule I to the *Financial Administration Act*,

(b) any department in respect of which a direction has been made under subsection 24(3), and

(c) any department, as defined in the *Financial Administration Act*, set out in the schedule;

"Commissioner"

"Commissioner" means the Commissioner of the Environment and Sustainable Development appointed under subsection 15.1(1);

"Crown corporation"

"Crown corporation" has the meaning assigned to that expression by section 83 of the *Financial Administration Act*;

"department"

"department" has the meaning assigned to that term by section 2 of the *Financial Administration Act*;

"registrar"

"registrar" means the Bank of Canada and a registrar appointed under Part IV of the *Financial Administration Act*;

"sustainable development"

"sustainable development" means development that meets the needs of the present without compromising the ability of future generations to meet their own needs;

"sustainable development strategy"

"sustainable development strategy", with respect to a category I department, means the department's objectives, and plans of action, to further sustainable development. 1976-77, c. 34, s. 2; 1984, c. 31, s. 14; 1995, c. 43, s. 2.

Auditor General of Canada

Appointment and tenure of office

3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem

(2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.

Re-appointment

(3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.

Vacancy

(4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General. 1976-77, c. 34, s. 3.

Salary

4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.

Pension benefits

(2) The provisions of the *Public Service Superannuation Act*, other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the *Diplomatic Service (Special) Superannuation Act* in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the *Public Service Superannuation Act* do not apply to him. 1976-77, c. 34, s. 4; 1980-81-82-83, c. 50, s. 23, c. 55, s. 1.

Duties

Examination

5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act. 1976-77, c. 34, s. 5.

Idem

6. The Auditor General shall examine the several financial statements required by section 64 of the *Financial Administration Act* to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have. 1976-77, c. 34, s. 6; 1980-81-82-83, c. 170, s. 25.

Annual and additional reports to the House of Commons

7. (1) The Auditor General shall report annually to the House of Commons and may make, in addition to any special report made under subsection 8(1) or 19(2) and the Commissioner's report under subsection 23(2), not more than three additional reports in any year to the House of Commons

(a) on the work of his office; and,

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

Idem

(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency;

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or

(f) money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

Submission of annual report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before December 31 in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it.

Notice of additional reports to Speaker and tabling in the House of Commons

(4) Where the Auditor General proposes to make an additional report under subsection (1), the Auditor General shall send written notice to the Speaker of the House of Commons of the subject-matter of the proposed report.

Submission of additional reports to Speaker and tabling in the House of Commons

(5) Each additional report of the Auditor General to the House of Commons made under subsection (1) shall be submitted to the House of Commons on the expiration of thirty days after the notice is sent pursuant to subsection (4) or any longer period that is specified in the notice and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it. 1976-77, c. 34, s. 7; 1994, c. 32, s. 1 and 2; 1995, c. 43, s. 3.

Special report to the House of Commons

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in the opinion of the Auditor General, should not be deferred until the presentation of the next report under subsection 7(1).

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 19(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting. 1976-77, c. 34, s. 8; 1994, c. 32, s. 3.

Idem

9. The Auditor General shall

(a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and

(b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act*,

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities. 1976-77, c. 34, s. 9.

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board. 1976-77, c. 34, s.10.

Inquiry and report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought. 1976-77, c. 34, s. 11.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board. 1976-77, c. 34, s. 12.

Access to Information

Access to information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*. 1976–77, c. 34, s.13.

Reliance on audit reports of Crown corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada. 1976–77, c. 34, s. 14.

Staff of the Auditor General

Officers, etc.

15. (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act*.

Contract for professional services

(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in appropriation Acts, contract for professional services.

Delegation to Auditor General

(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under section 21 of that Act and inquiries under section 34 of that Act.

Suspension

(4) The Auditor General may suspend from the performance of his duty any person employed in his office. 1976–77, c. 34, s. 15; 1992, c. 54, s. 79.

Appointment of Commissioner

15.1 (1) The Auditor General shall, in accordance with the *Public Service Employment Act*, appoint a senior officer to be called the Commissioner of the Environment and Sustainable Development who shall report directly to the Auditor General.

Commissioner's duties

(2) The Commissioner shall assist the Auditor General in performing the duties of the Auditor General set out in this Act that relate to the environment and sustainable development. 1995, c. 43, s. 4.

Responsibility for personnel management

16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph 7(1)(e) and sections 11 to 13 of that Act. 1976–77, c. 34, s.16.

Classification standards

17. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office. 1976–77, c. 34, s. 18.

Delegation

18. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 64 of the *Financial Administration Act* and his reports to the House of Commons under this Act, and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General. 1976-77, c. 34, s. 19.

Estimates

Estimates

19. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office. 1976-77, c. 34, s. 20.

Appropriation allotments

20. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General. 1976-77, c. 34, s. 21.

Audit of the Office of the Auditor General

Audit of the office of the Auditor General

21. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting. 1976-77, c. 34, s. 22.

Sustainable Development

Purpose

21.1 The purpose of the Commissioner is to provide sustainable development monitoring and reporting on the progress of category I departments towards sustainable development, which is a continually evolving concept based on the integration of social, economic and environmental concerns, and which may be achieved by, among other things,

(a) the integration of the environment and the economy;
(b) protecting the health of Canadians;
(c) protecting ecosystems;
(d) meeting international obligations;
(e) promoting equity;
(f) an integrated approach to planning and making decisions that takes into account the environmental and natural resource costs of different economic options and the economic costs of different environmental and natural resource options;
(g) preventing pollution; and
(h) respect for nature and the needs of future generations. 1995, c. 43, s. 5.

Petitions received

22. (1) Where the Auditor General receives a petition in writing from a resident of Canada about an environmental matter in the context of sustainable development that is the responsibility of a category I department, the Auditor General shall make a record of the petition and forward the petition within fifteen days after the day on which it is received to the appropriate Minister for the department.

Acknowledgement to be sent

(2) Within fifteen days after the day on which the Minister receives the petition from the Auditor General, the Minister shall send to the person who made the petition an acknowledgement of receipt of the petition and shall send a copy of the acknowledgement to the Auditor General.

Minister to respond

(3) The Minister shall consider the petition and send to the person who made it a reply that responds to it, and shall send a copy of the reply to the Auditor General, within

(a) one hundred and twenty days after the day on which the Minister receives the petition from the Auditor General; or

(b) any longer time, where the Minister personally, within those one hundred and twenty days, notifies the person who made the petition that it is not possible to reply within those one hundred and twenty days and sends a copy of that notification to the Auditor General.

Multiple petitioners

(4) Where the petition is from more that one person, it is sufficient for the Minister to send the acknowledgement and reply, and the notification, if any, to one or more of the petitioners rather than to all of them. 1995, c. 43, s. 5.

Duty to monitor

23. (1) The Commissioner shall make any examinations and inquiries that the Commissioner considers necessary in order to monitor

(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before the House of Commons under section 24; and

(b) the replies by Ministers required by subsection 22(3).

Commissioner's report

(2) The Commissioner shall, on behalf of the Auditor General, report annually to the House of Commons concerning anything that the Commissioner considers should be brought to the attention of that House in relation to environmental and other aspects of sustainable development, including

(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before that House under section 24;

(b) the number of petitions recorded as required by subsection 22(1), the subject matter of the petitions and their status; and

(c) the exercising of the authority of the Governor in Council under any of subsections 24(3) to (5).

Submission and tabling of report

(3) The report required by subsection (2) shall be submitted to the Speaker of the House of Commons and shall be laid before that House by the Speaker on any of the next fifteen days on which that House is sitting after the Speaker receives it. 1995, c. 43, s. 5.

Strategies to be tabled

24. (1) The appropriate Minister for each category I department shall cause the department to prepare a sustainable development strategy for the department and shall cause the strategy to be laid before the House of Commons

(a) within two years after this subsection comes into force; or

(b) in the case of a department that becomes a category I department on a day after this subsection comes into force, before the earlier of the second anniversary of that day and a day fixed by the Governor in Council pursuant to subsection (4).

Updated strategies to be tabled

(2) The appropriate Minister for the category I department shall cause the department's sustainable development strategy to be updated at least every three years and shall cause each updated strategy to be laid before the House of Commons on any of the next fifteen days on which that House is sitting after the strategy is updated.

Governor in Council direction

(3) The Governor in Council may, on that recommendation of the appropriate Minister for a department not named in Schedule I to the *Financial Administration Act*, direct that the requirements of subsections (1) and (2) apply in respect of the department.

Date fixed by Governor in Council

(4) On the recommendation of the appropriate Minister for a department that becomes a category I department after this subsection comes into force, the Governor in Council may, for the purpose of subsection (1), fix the day before which the sustainable development strategy of the department shall be laid before the House of Commons.

Regulations

(5) The Governor in Council may, on the recommendation of the Minister of the Environment, make regulations prescribing the form in which sustainable development strategies are to be prepared and the information required to be contained in them. 1995, c. 43, s. 5.

Appendix B *Financial Administration Act*

R.S., c. F-11
Extracts from Part X

CROWN CORPORATIONS
Financial Management

Books and systems

131. (1) Each parent Crown corporation shall cause

(a) books of account and records in relation thereto to be kept, and

(b) financial and management control and information systems and management practices to be maintained,

in respect of itself and each of its wholly-owned subsidiaries, if any.

Idem

(2) The books, records, systems and practices referred to in subsection (1) shall be kept and maintained in such manner as will provide reasonable assurance that

(a) the assets of the corporation and each subsidiary are safeguarded and controlled;

(b) the transactions of the corporation and each subsidiary are in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(c) the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently and the operations of the corporation and each subsidiary are carried out effectively.

Internal audit

(3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly-owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the benefits to be derived from those audits do not justify their cost.

Financial statements

(4) Each parent Crown corporation shall cause financial statements to be prepared annually, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with generally accepted accounting principles as supplemented or augmented by regulations made pursuant to subsection (6) if any.

Form of financial statements

(5) The financial statements of a parent Crown corporation and of a wholly-owned subsidiary shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation or subsidiary.

Regulations

(6) The Treasury Board may, for the purposes of subsection (4), make regulations respecting financial statements either generally or in respect of any specified parent Crown corporation or any parent Crown corporation of a specified class, but such regulations shall, in respect of the preparation of financial statements, only supplement or augment generally accepted accounting principles. 1991, c. 24, s. 41.

Auditor's Reports

Annual auditor's report

132. (1) Each parent Crown corporation shall cause an annual auditor's report to be prepared, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with the regulations, on

(a) the financial statements referred to in section 131 and any revised financial statement referred to in subsection 133(3); and

(b) any quantitative information required to be audited pursuant to subsection (5).

Contents (2) A report under subsection (1) shall be addressed to the appropriate Minister and shall

(a) include separate statements, whether in the auditor's opinion,

(i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year,

(ii) the quantitative information is accurate in all material respects and, if applicable, was prepared on a basis consistent with that of the preceding year, and

(iii) the transactions of the corporation and of each subsidiary that have come to his notice in the course of the auditor's examination for the report were in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(b) call attention to any other matter falling within the scope of the auditor's examination for the report that, in his opinion, should be brought to the attention of Parliament.

Regulations (3) The Treasury Board may make regulations prescribing the form and manner in which the report referred to in subsection (1) is to be prepared.

Separate reports (4) Notwithstanding any other provision of this Part, the auditor of a parent Crown corporation may prepare separate annual auditor's reports on the statements referred to in paragraph (1)(a) and on the information referred to in paragraph (1)(b) if, in the auditor's opinion, separate reports would be more appropriate.

Audit of quantitative information (5) The Treasury Board may require that any quantitative information required to be included in a parent Crown corporation's annual report pursuant to subsection 150(3) be audited.

Other reports (6) The auditor of a parent Crown corporation shall prepare such other reports respecting the corporation or any wholly-owned subsidiary of the corporation as the Governor in Council may require.

Examination (7) An auditor shall make such examination as he considers necessary to enable him to prepare a report under subsection (1) or (6).

Reliance on internal audit (8) An auditor shall, to the extent he considers practicable, rely on any internal audit of the corporation being audited that is conducted pursuant to subsection 131(3). 1991, c. 24, s.42.

Errors and omissions **133.** (1) A director or officer of a Crown corporation shall forthwith notify the auditor and the audit committee of the corporation, if any, of any error or omission of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on or in a report prepared by the auditor or a former auditor pursuant to section 132.

Idem (2) Where an auditor or former auditor of a Crown corporation is notified or becomes aware of any error or omission in a financial statement that the auditor or former auditor has reported on or in a report prepared by the auditor or former auditor pursuant to section 132, he shall forthwith notify each director of the corporation of the error or omission if he is of the opinion that the error or omission is material.

Correction (3) Where an auditor or former auditor of a Crown corporation notifies the directors of an error or omission in a financial statement or report pursuant to subsection (2), the corporation shall prepare a revised financial statement or the auditor or former auditor shall issue a correction to the report, as the case may be, and a copy thereof shall be given to the appropriate Minister. 1984, c. 31, s. 11.

Auditors

Appointment of auditor **134.** (1) The auditor of a parent Crown corporation shall be appointed annually by the Governor in Council, after the appropriate Minister has consulted the board of directors of the corporation, and may be removed at any time by the Governor in Council, after the appropriate Minister has consulted the board.

Auditor General (2) On and after January 1, 1989, the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each parent Crown corporation named in Part I of Schedule III, unless the Auditor General waives the requirement that he be so appointed.

Idem (3) Subsections (1) and (2) do not apply in respect of any parent Crown corporation the auditor of which is specified by any other Act of Parliament to be the Auditor General of Canada, but the Auditor General is eligible to be appointed the auditor, or a joint auditor, of a parent Crown corporation pursuant to subsection (1) and section 135 does not apply to him.

Exception (4) Notwithstanding subsection (1), where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the auditor of the subsidiary, and subsections (6) and sections 135 to 137 apply in respect of that auditor as though the references therein to a parent Crown corporation were references to the subsidiary.

Criteria for appointment (5) The Governor in Council may make regulations prescribing the criteria to be applied in selecting an auditor for appointment pursuant to subsection (1) or (4).

Re-appointment (6) An auditor of a parent Crown corporation is eligible for re-appointment on the expiration of his appointment.

Continuation in office (7) Notwithstanding subsection (1), if an auditor of a parent Crown corporation is not appointed to take office on the expiration of the appointment of an incumbent auditor, the incumbent auditor continues in office until his successor is appointed. 1984, c.31, s.11.

Persons not eligible **135.** (1) A person is disqualified from being appointed or re-appointed or continuing as an auditor of a parent Crown corporation pursuant to section 134 if that person is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or any of its affiliates.

Independence (2) For the purpose of this section,

(a) independence is a question of fact; and

(b) a person is deemed not to be independent if that person or any of his business partners

(i) is a business partner, director, officer or employee of the parent Crown corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates,

(ii) beneficially owns or controls, directly or indirectly through a trustee, legal representative, agent or other intermediary, a material interest in the shares or debt of the parent Crown corporation or any of its affiliates, or

(iii) has been a receiver, receiver-manager, liquidator or trustee in bankruptcy of the parent Crown corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.

Resignation (3) An auditor of a parent Crown corporation who becomes disqualified under this section shall resign forthwith after becoming aware of his disqualification. 1984, c.31, s.11.

Qualifications preserved **136.** Nothing in sections 134 and 135 shall be construed as empowering the appointment, re-appointment or continuation in office as an auditor of a parent Crown corporation of any person who does not meet any qualifications for such appointment, re-appointment or continuation established by any other Act of Parliament. 1984, c. 31, s. 11.

Resignation **137.** A resignation of an auditor of a parent Crown corporation becomes effective at the time the corporation receives a written resignation from the auditor or at the time specified in the resignation, whichever is later. 1984, c. 31, s. 11.

Special Examination

Special examination **138.** (1) Each parent Crown corporation shall cause a special examination to be carried out in respect of itself and its wholly-owned subsidiaries, if any, to determine if the systems and practices referred to in paragraph 131(1)(b) were, in the period under examination, maintained in a manner that provided reasonable assurance that they met the requirements of paragraphs 131(2)(a) and (c).

Time for examination

(2) A special examination shall be carried out at least once every five years and at such additional times as the Governor in Council, the appropriate Minister or the board of directors of the corporation to be examined may require.

Plan

(3) Before an examiner commences a special examination, he shall survey the systems and practices of the corporation to be examined and submit a plan for the examination, including a statement of the criteria to be applied in the examination, to the audit committee of the corporation, or if there is no audit committee, to the board of directors of the corporation.

Resolution of disagreements

(4) Any disagreement between the examiner and the audit committee or board of directors of a corporation with respect to a plan referred to in subsection (3) may be resolved

(a) in the case of a parent Crown corporation, by the appropriate Minister; and

(b) in the case of a wholly-owned subsidiary, by the parent Crown corporation that wholly owns the subsidiary.

Reliance on internal audit

(5) An examiner shall, to the extent he considers practicable, rely on any internal audit of the corporation being examined conducted pursuant to subsection 131(3). 1984, c.31, s.11.

Report

139. (1) An examiner shall, on completion of the special examination, submit a report on his findings to the board of directors of the corporation examined.

Contents

(2) The report of an examiner under subsection (1) shall include

(a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection 138(3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and

(b) a statement of the extent to which the examiner relied on internal audits. 1984, c.31, s.11.

Special report of appropriate Minister

140. Where the examiner of a parent Crown corporation, or a wholly owned subsidiary of a parent Crown corporation, named in Part I of Schedule III is of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the board of directors of the corporation, or with the board of the subsidiary and corporation, as the case may be, report that information to the Minister and furnish the board or boards with a copy of the report. 1984, c.31, s.11.

Special report to Parliament

141. Where the examiner of a parent Crown corporation, or a wholly-owned subsidiary of a parent Crown corporation, named in Part I of Schedule III of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the board of directors of the corporation, or with the boards of the subsidiary and corporation, as the case may be, prepare a report thereon for inclusion in the next annual report of the corporation and furnish the board or boards, the appropriate Minister and the Auditor General of Canada with copies of the report. 1984, c.31, s.11.

Examiner

142. (1) Subject to subsections (2) and (3), a special examination referred to in section 138 shall be carried out by the auditor of a parent Crown corporation.

Idem

(2) Where, in the opinion of the Governor in Council, a person other than the auditor of a parent Crown corporation should carry out a special examination, the Governor in Council may, after the appropriate Minister has consulted the board of directors of the corporation, appoint an auditor who is qualified for the purpose to carry out the examination in lieu of the auditor of the corporation and may, after the appropriate Minister has consulted the board, remove that qualified auditor at any time.

Exception

(3) Where a special examination is to be carried out in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the qualified auditor who is to carry out the special examination.

Applicable provisions

(4) Subject to subsection (5), sections 135 and 137 apply in respect of an examiner as though the references therein to an auditor were references to an examiner.

Auditor General eligible

(5) The Auditor General of Canada is eligible to be appointed an examiner and section 135 does not apply to the Auditor General of Canada in respect of such an appointment. 1984, c. 31, s. 11.

Consultation with Auditor General

Consultation with Auditor General

143. The auditor or examiner of a Crown corporation may at any time consult the Auditor General of Canada on any matter relating to his audit or special examination and shall consult the Auditor General with respect to any matter that, in the opinion of the auditor or examiner, should be brought to the attention of Parliament pursuant to paragraph 132(2)(b) or section 141. 1984, c. 31, s. 11.

Right to Information

Right to Information

144. (1) On the demand of the auditor or examiner of a Crown corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such

(a) information and explanations, and

(b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries

as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.

Idem

(2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall

(a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the present or former directors, officers, employees or agents are reasonably able to furnish; and

(b) furnish the auditor or examiner with the information and explanations so obtained.

Reliance on reports

(3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

Policy

Restriction

145. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of

(a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;

(b) the objectives of the corporation; and

(c) any business or policy decision of the corporation or of the Government of Canada. 1984, c. 31, s. 11.

Qualified Privilege

Qualified privilege

146. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation or a wholly-owned subsidiary has qualified privilege. 1991, c. 24, s. 43.

Costs

Cost of audit and examination

147. (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 132, 139, 140 or 141 shall be reported to the President of the Treasury Board.

Idem

(2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 132, 139, 140 or 141 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

Audit Committee

Audit committee

148. (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

Idem

(2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

Duties

(3) The audit committee of a parent Crown corporation shall

(a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;

(b) oversee any internal audit of the corporation that is conducted pursuant to subsection 131(3);

(c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 132(1);

(d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in sections 138 to 141; and

(e) perform such other functions as are assigned to it by the board of directors or the charter or by-laws of the corporation.

Auditor's or examiner's attendance

(4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard at each meeting, and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting

(5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly-owned subsidiary

(6) Where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary, separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though

(a) the references in subsections (1) to (5) to a parent Crown corporation were references to the subsidiary; and

(b) the reference in paragraph (3)(a) to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

Reports

Accounts, etc. to Treasury Board or appropriate Minister

149. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on material developments

(2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on wholly-owned subsidiaries

(3) Each parent Crown corporation shall forthwith notify the appropriate Minister and the President of the Treasury Board of the name of any corporation that becomes or ceases to be a wholly-owned subsidiary of the corporation. 1984, c. 31, s. 11.

Annual report

150. (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.

Reference to committee

(2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the businesses and activities of the corporation submitting the report.

Form and contents

(3) The annual report of a parent Crown corporation shall include

(a) the financial statements of the corporation referred to in section 131,

(b) the annual auditor's report referred to in subsection 132(1),

(c) a statement on the extent to which the corporation has met its objectives for the financial year,

(d) such quantitative information respecting the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included in the annual report, and

(e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included in the annual report,

and shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly-owned subsidiaries, if any.

Idem

(4) In addition to any other requirements under this Act or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1991, c. 24, s. 49.

Annual consolidated report

151. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.

Reference to committee

(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.

Contents

(3) The annual consolidated report referred to in subsection (1) shall include

(a) a list naming, as of a specified date, all Crown corporations and all corporations of which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation,

(b) employment and financial data, including aggregate borrowings of parent Crown corporations, and

(c) such other information as the President of the Treasury Board may determine. 1984, c. 31, s. 11.

Annual report

152. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause to be laid before each House of Parliament a copy of a report indicating the summaries and annual reports that under this Part were to be laid before that House by July 31 in that year, the time at, before or within which they were to be laid and the time they were laid before that House.

Attest

(2) The accuracy of the information contained in the report referred to in subsection (1) shall be attested by the Auditor General of Canada in the Auditor General's report to the House of Commons. 1991, c. 24, s. 44.

Appendix C Reports of the Standing Committee on Public Accounts to the House of Commons, 2001–02

The following reports are available on the Web site of Canada's Parliament (www.parl.gc.ca).

37th Parliament, 1st Session

Report 9. Chapter 34 (Other Audit Observations: Canada Customs and Revenue Agency and Human Resources Development Canada) of the December 2000 Report of the Auditor General of Canada). (Tabled in the House 31 October 2001)

Report 10. Chapter 15 (Health Canada—First Nations Health: Follow-up) of the October 2000 Report of the Auditor General of Canada. (Tabled in the House 6 December 2001)

Report 11. Chapter 21 (Post Secondary Recruitment Program of the Federal Public Service) of the December 2000 Report of the Auditor General of Canada. (Tabled in the House 6 December 2001)

Report 12. Chapter 9 (Streamlining the Human Resource Management Regime: A Study of Changing Roles and Responsibilities) of the April 2000 Report of the Auditor General of Canada. (Tabled in the House 6 December 2001)

Report 13. Labour Management Relations in the Federal Public Service (Fryer Report). (Tabled in the House 7 December 2001)

Report 14. Chapter 25 (Canadian Food Inspection Agency: Food Inspection Programs) of the December 2000 Report of the Auditor General of Canada. (Tabled in the House 19 February 2002)

Report 15. Chapter 18 (Governance of Crown Corporations) of the December 2000 Report of the Auditor General of Canada. (Tabled in the House 19 February 2002)

Report 16. Chapter 24 (Federal Health and Safety Regulatory Programs) of the December 2000 Report of the Auditor General of Canada. (Tabled in the House 19 February 2002)

Report 17. Chapters 26 and 27 (Health Canada: Regulatory Regime of Biologics, and Canadian Nuclear Safety Commission: Power Reactor Regulation) of the December 2000 Report of the Auditor General of Canada. (Tabled in the House 12 March 2002)

Report 18. Public Accounts of Canada 2000-2001. (Tabled in the House 12 March 2002)

Report 19. Vote 20 under FINANCE in the Main Estimates for the fiscal year ending 31 March 2003. (Tabled in the House 30 April 2002)

Report 20. Chapter 10 (National Defence—In Service Equipment) of the December 2001 Report of the Auditor General's of Canada. (Tabled in the House 22 May 2002)

Report 21. Chapter 10 (Transport Canada—Airport Transfers: National Airports System) of the October 2000 Report of the Auditor General of Canada. (Tabled in the House 22 May 2002)

Report 22. Chapter 31 (Fisheries and Oceans—Fleet Management) of the December 2000 Report of the Auditor General of Canada. (Tabled in the House 22 May 2002)

Report 23. Chapter 7 (Canada Customs and Revenue Agency—International Tax Administration: Non-Residents Subject to Canadian Income Tax) of the December 2001 Report of the Auditor General of Canada. (Tabled in the House 4 June 2002)

Report 24. Chapters 2 and 3 (Recruitment for Canada's Future Public Service: Changing the System and Changing the Practices) of the December 2001 Report of the Auditor General of Canada. (Tabled in the House 4 June 2002)

Appendix D Report on the audit of the President of the Treasury Board's report to Parliament

Tablings in Parliament for parent Crown corporations: Annual reports and summaries of corporate plans and budgets

The *Financial Administration Act* requires the President of the Treasury Board to lay before each House of Parliament a report concerning the timing of tabling, by appropriate ministers, of annual reports and summaries of corporate plans and budgets of Crown corporations subject to the reporting provisions of Part X of the Act. The Act also requires the Auditor General to audit the accuracy of the report and to present the results of this audit in her annual report to the House of Commons.

The report on tablings is the responsibility of the President of the Treasury Board and is included in her annual report to Parliament, *Crown Corporations and Other Corporate Interests of Canada*, which is required to be tabled not later than 31 December (not tabled for 2002 at time of going to press). The report on these tablings allows Parliament to hold the appropriate ministers (and, ultimately, the Crown corporations) accountable for providing, within the relevant statutory deadlines, the information required under the *Financial Administration Act*. Accordingly, the report is required to indicate the time at, before, or within which the annual reports and the summaries of corporate plans, capital budgets, and operating budgets (and amendments to them) were required to be tabled before each House during the reporting period, and the time they were actually tabled.

Auditor's report

To the House of Commons

As required by subsection 152(2) of the *Financial Administration Act*, I have audited the information contained in the President of the Treasury Board's report on tablings for the year ended 31 July 2002. The report on tablings is the responsibility of the President of the Treasury Board. My responsibility is to express an opinion on the report on tablings based on my audit.

I conducted my audit in accordance with the standards for assurance engagements established by the Canadian Institute of Chartered Accountants. Those standards require that I plan and perform an audit to obtain reasonable assurance as to whether the report on tablings is free of significant misstatement. My audit included examining evidence supporting the deadlines, the actual tabling dates, and other disclosures provided in the report on tablings.

In my opinion, the information contained in the report on tablings is accurate in all significant respects, in accordance with the description of the Deadlines for Tabling in Parliament that accompanies the report.

The following paragraph is intended to highlight certain information that I believe may be of interest to parliamentarians and that is not highlighted or disclosed in the report on tablings in its current format. This information indicates that compared with last year, the timeliness of corporate reporting has deteriorated further.

This year's report on tablings identifies 169 instances where documents were tabled late. This represents an increase of 66 over last year in the number of late tablings. In addition, the report does not disclose that in 33 instances (compared with 23 in 2001), corporate plans were approved by the Governor in Council after the beginning of the period covered by the plans. In 18 of those instances (13 in 2001), plans were approved more than two months after the beginning of the period covered.

R. Flageole

Richard Flageole, FCA
Assistant Auditor General
for the Auditor General of Canada

Ottawa, Canada
5 November 2002

Appendix E Costs of Crown corporation audits conducted by the Office of the Auditor General of Canada

Section 147 of the *Financial Administration Act* requires that the Office disclose the costs of preparing audit reports on all Crown corporations other than those exempted under section 85 of the Act (Exhibit E.1). An audit report includes an opinion on a corporation's financial statements and on its compliance with specified authorities. It may also include reporting on any other matter deemed significant.

The Office is also required by section 68 of the *Broadcasting Act* to report the cost of any audit report on the Canadian Broadcasting Corporation. For the fiscal year ended 31 March 2002, the full cost of the annual audit report was $583,768.

The objective of a special examination is to determine whether a corporation's financial and management control and information systems and its management practices provide reasonable assurance that:

- assets have been safeguarded and controlled;
- financial, human, and physical resources have been managed economically and efficiently; and
- operations have been carried out effectively.

In 2001–02, the Office completed the special examination of the Canadian Museum of Nature. The cost was $714,838.

Exhibit E.1 Cost of preparing annual audit reports for fiscal years ending on or before 31 March 2002

Crown Corporation	Fiscal year ended	Cost
Atlantic Pilotage Authority	31.12.01	$ 46,671
Atomic Energy of Canada Limited (joint auditor)	31.03.02	213,645
Business Development Bank of Canada (joint auditor)	31.03.02	269,986
Canada Deposit Insurance Corporation	31.03.02	144,827
Canada Development Investment Corporation (joint auditor)	31.12.01	23,071
Canada Lands Company Limited (joint auditor)	31.03.02	306,527
Canada Mortgage and Housing Corporation (joint auditor)	31.12.01	362,267
Canadian Commercial Corporation	31.03.02	154,811
Canadian Dairy Commission	31.07.01	89,898
Canadian Museum of Civilization	31.03.02	99,190
Canadian Tourism Commission	31.12.01	330,632
Canadian Museum of Nature	31.03.02	104,439
Cape Breton Development Corporation	31.03.02	133,323
Cape Breton Growth Fund	31.03.02	23,937
Defence Construction (1951) Limited	31.03.02	65,655
Enterprise Cape Breton Corporation	31.03.02	107,517
Export Development Canada	31.12.01	542,865
Farm Credit Canada	31.03.02	339,132
Federal Bridge Corporation Ltd	31.03.02	47,906
Freshwater Fish Marketing Corporation	30.04.01	105,996
Great Lakes Pilotage Authority	31.12.01	84,998
Laurentian Pilotage Authority	31.12.01	80,623
Jacques Cartier and Champlain Bridges Incorporated	31.03.02	73,973
Marine Atlantic Inc.	31.12.01	177,298
National Capital Commission	31.03.02	147,364
National Gallery of Canada	31.03.02	94,344
National Museum of Science and Technology	31.03.02	112,677
Old Port of Montreal Corporation Inc.	31.03.02	236,261
Pacific Pilotage Authority	31.12.01	37,402
Petro-Canada Limited	31.12.01	313
Queens Quay West Land Corporation	31.03.02	56,225
Royal Canadian Mint	31.12.01	312,409
Ridley Terminals Inc.	31.12.01	46,046
Seaway International Bridge Corporation Ltd.	31.12.01	41,787
Standards Council of Canada	31.03.02	62,690
VIA Rail Canada Inc. (joint auditor)	31.12.01	243,844

Report of the Auditor General of Canada to the House of Commons—December 2002

Main Table of Contents

Matters of Special Importance—2002
Foreword and Main Points

Chapter 1 Streamlining First Nations Reporting to Federal Organizations

Chapter 2 Fisheries and Oceans Canada—Contributing to Safe and Efficient Marine Navigation

Chapter 3 *Special Import Measures Act*: Protecting Against Dumped or Subsidized Imports

Chapter 4 Canada Customs and Revenue Agency—Taxing International Transactions of Canadian Residents

Chapter 5 Financial Management and Control in the Government of Canada

Chapter 6 Statistics Canada—Managing the Quality of Health Statistics

Chapter 7 Canadian Space Agency—Implementing the Canadian Space Program

Chapter 8 Public Works and Government Services Canada—Acquisition of Office Space

Chapter 9 Modernizing Accountability in the Public Sector

Chapter 10 Department of Justice—Costs of Implementing the Canadian Firearms Program

Chapter 11 Other Audit Observations

Appendices